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Volume II, Number 4 October 1982

MEMPHIS STATE UNIVERSITY

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HOUSING CONSTRUCTION ACTIVITY IN MEMPHIS/SHELBY COUNTY

*Cyril F. Chang**

Following the national trend, the housing sector of the Memphis/Shelby County economy has experienced four consecutive years of recession. According to a recent *Memphis Housing Market Area Report*, total residential building permits dropped from about 6,000 in 1977 to about 1,500 in 1981.[1] Housing starts dropped during the same period from the 1977 peak of close to 5,000 units to the 1981 low of less than 500 units.[2] The loss of income, sales, and job opportunities has been enormous in both financial and human terms. The consensus among experts in the field seems to be that the market situation will not improve until the national economy recovers from the current recession and interest rates drop to a more manageable level.

This article investigates the supply side of the residential housing market in Memphis and Shelby County. The focus is on such key variables as housing permits, starts, square footage constructed, and the contract value. The purpose is to develop econometric models capable of forecasting residential housing construction activities. The cost of construction is also analyzed to provide insight into the relationship between construction costs and the growth and contraction of the housing construction industry of the local economy.

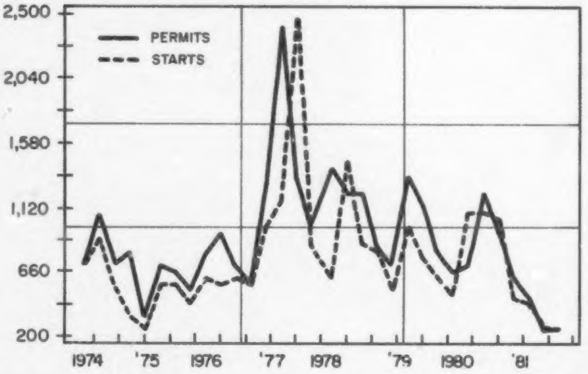
Analysis of Construction Permits

At both national and local levels, the building permit statistics provide one of the major indicators of general economic activities. The importance of this statistical series lies in its close relationship to the future fluctuations in the housing sector of the economy. According to a recent report of the U.S. Department of Commerce, for example, "approximately 60 percent of the one-family houses authorized are started during the month of authorization, and over 90 percent within four months of authorization."[3] Multifamily units start more erratically, but they mostly start within a few months of authorization, according to the same report.

As demonstrated by recent data, the Memphis/ Shelby County housing market exhibits the same pattern of relationship between housing permits and starts. Figure 1 indicates that housing permits and starts in Memphis and Shelby County have in recent years moved up and down together, with permits leading starts by about a month. A reliable forecast of housing permits therefore provides a reliable forecast of housing starts.

Figure 1

BUILDING PERMITS AND STARTS



Source: Bureau of Business and Economic Research, Memphis State University, and F. W. Dodge Division, McGraw-Hill Information Systems.

To predict residential building permits, the multiple regression technique was used to establish the quantitative relationship between housing permits and their determinants, such as the interest rate, past patterns of housing activities, and the level of local general economic activities. Quarterly data were collected for the period between the first quarter of 1967 to the fourth quarter of 1980 from the *Construction Review*, the *Dodge Construction Potentials Bulletin*,[4] the *Federal Reserve Bulletin*, and various publications of the Bureau of Business and Economic Research, Memphis State University. For the benefit of those readers who are familiar with economics and quantitative methods, the econometric model of building permits is presented in an appendix.

Statistically, the analytical results are encouraging: The regression coefficients are all significant and have the right signs. The economic meaning of the regression coefficients must also be interpreted. First, because the equations are in log-linear form, the regression coefficients provide estimates of various elasticities. For example, the building permit elasticities are 1.2869 and 1.5409 according to model A and model B, respectively.[5] This implies that a 1 percent increase in total building permits issued in the state of Tennessee is associated with a 1.2869 percent to 1.5409 percent increase in the issuance of building permits in Memphis and Shelby County. Compared to building permits issued in the state as a whole, residential housing building permit authorizations in Memphis and

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**Assistant Professor, Department of Economics, Memphis State University, Memphis, Tennessee.*

Shelby County seem to be more volatile during both expansionary and contractionary periods.

The interest rate variable and the coincident index variable[6] are included in the regression equations because they are believed to have significant influence over builders' psychology. They do not appear in the same equation, however, because of the problem of multicollinearity.[7] The interest rate elasticity is -0.95, suggesting that a 1 percent increase in the interest rate will cause building permits to decline by approximately 0.95 of 1 percent. Housing building permits, in other words, are about unitary elastic with respect to the interest rate. The coincident index elasticity is -0.7492. This suggests that building permits are less sensitive to the general level of economic activities in the local economy than to the interest rate. The negative sign is interesting because it can be interpreted to mean that the current decline in the general level of economic activities actually signals a rise in building permit authorizations in the near future. A rise in the building permits, in turn, is one of the first signs of economic recovery. Seasonal dummy variables were tried to account for the seasonal fluctuations of permit applications, but they turned out to be insignificant. This is, however, consistent with the conclusion of other studies that building permits vary more with weather than with the season.[8]

The reliability of the prediction results was also tested. The mean absolute percentage errors (MAPE) for the 1967-80 period are 3.15 percent and 4.263 percent for model A and model B, respectively. This means that the models are capable of tracking previous growth and contraction in permit issuance with an error margin of only 3 to 4 percent on the average.

Analysis of Total Square Footage

The output of the residential construction industry is the total square footage constructed. An econometric model capable of predicting housing construction has been built using such variables as the interest rate, lagged housing construction in Memphis and Shelby County, and housing construction in the state of Tennessee as the determinants of housing construction in Memphis and Shelby County. This model is presented in the appendix.

The empirical results are favorable. For example, the MAPE statistic is only 2.78 percent, indicating that the prediction error is small when the model is used to track historical fluctuations in the total square footage of residential housing construction. Also, when seasonal dummy variables were included in the model, only the spring season dummy variable was significant and had the negative sign. This can be interpreted to mean that housing construction is slower in the spring due to colder weather. But on the year-round basis, the lack of significance of the seasonal dummy variables in general also suggests that housing construction does not exhibit strong seasonal patterns.

The housing construction elasticity with respect to total housing construction in the state of Tennessee is 1.3443. Accordingly, a 1 percent increase in housing construction in the state corresponds to a 1.3443 percent increase in housing construction in Memphis and Shelby County. The interest rate elasticity is -0.9. This is consistent with the earlier results that a 1 percent increase in the interest rate will bring about approximately a 1 percent decrease in the issuance of building permits and that a small portion of the permits issued will never be used by the builders for actual construction.

Analysis of Construction Costs

The *Dodge Construction Potentials Bulletin* provides quarterly data on total contract value and square footage constructed for both Memphis and Shelby County. Because the value figures represent actual construction costs exclusive of the value of land, architects' fees, and the costs of construction equipment, total contract value varies strictly with total constructed square footage. Total contract value is therefore a proxy of total variable costs of the housing construction industry.

Quadratic and log-linear total variable cost functions were estimated using quarterly data for the period of 1967 to 1980. The estimated cost equations can be found in the appendix.

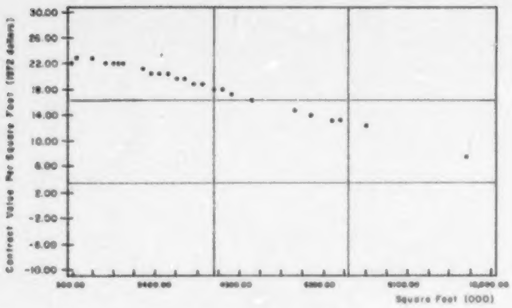
The average and marginal cost functions were also derived. They are represented graphically in Figures 2 and 3. In the relevant range of data observation between 500,000 square feet and 10,000,000 square feet, both the average and marginal costs drop from about $22 per square foot to as low as only $10 in 1972 dollars. The lower construction costs at higher quantity, it is theorized, are due to better utilization of the existing capital equipment and lower per unit overhead costs.

This conclusion has significant implications for the current slump in the housing construction industry. Recently, quarterly housing construction in Memphis and Shelby County has been in the quantity of about 1,000,000 square feet. In addition to the jobs and income that will be created by more residential construction, a rapid recovery of the industry will also bring about the added benefits of lower construction costs per housing unit.

Conclusion

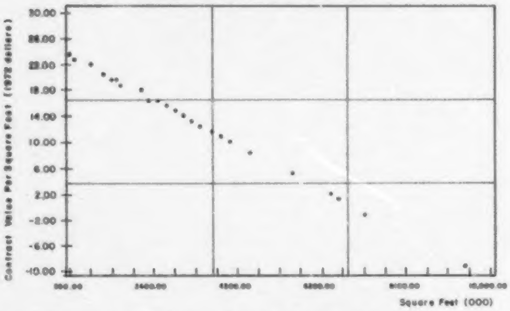
This article presents econometric models of housing building permits, residential housing construction, and construction costs. The twofold purpose of the discussion is to explain the relationship between these key variables of the housing construction industry and their main determinants, and to offer a framework for forecasting. It is concluded that interest rates, past patterns of housing activities, and the level of local general economic activities are the main determinants of current housing construction activities. The housing construction sector of the Memphis/Shelby County economy exhibits more volatile fluctuations than the housing construction industry of the state as a whole. Finally, on the basis of their ability to track historical growth and contraction in the local residential housing construction industry, the performance of the forecasting models is satisfactory.

Figure 2a
AVERAGE COST CURVE



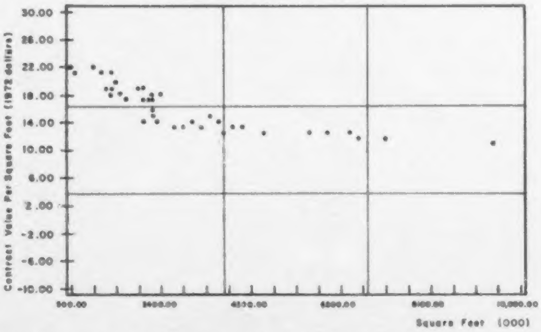
Note: The total variable cost function is in quadratic form.

Figure 2b
MARGINAL COST CURVE



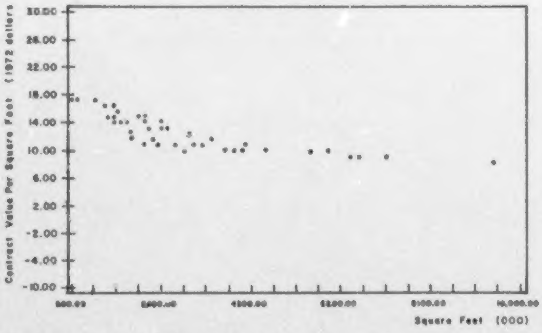
Note: The total variable cost function is in quadratic form.

Figure 3a
AVERAGE COST CURVE



Note: The total variable cost function is in log-linear form.

Figure 3b
MARGINAL COST CURVE



Note: The total variable cost function is in log-linear form.

Appendix
CONSTRUCTION PERMIT EQUATIONS

Independent Variables	Dependent Variable ln PERMIT Model A	 Model B
Constant	-1.223	-0.0350
ln TNPERMIT	1.0223	0.8982
	(0.1393)	(0.1453)
ln PERMIT1	0.2056	0.4171
	(0.0540)	(0.0792)
ln AAA1	-0.9464	
	(0.1672)	
ln CODEX1		-0.7492
		(0.1253)
R^2	0.78	0.79
$\bar{R}^2$	0.77	0.78
F	62.1199	65.5915
SEE	0.3137	0.3070
DW	1.89	2.17
MAPE	0.0316	0.0426

Note: Numbers in parentheses are standard errors.

ln PERMIT = natural log of total residential building permits issued in Memphis and Shelby County
ln TNPERMIT = natural log of total residential building permits issued in the state of Tennessee
ln PERMIT1 = natural log of PERMIT lagged by one quarter
ln AAA1 = natural log of triple A corporate bond rate lagged by one period
ln CODEX1 = natural log of Memphis business activity coincident index lagged by one period

TOTAL SQUARE FOOTAGE EQUATION

$$\ln SQFT = -1.973304 + \underset{(0.16628)}{1.052139} \ln TNSQFT + \underset{(0.05529)}{0.217349} \ln SQFT1 \underset{(0.18377)}{-0.908071} \ln AAA1$$

$R^2 = 0.68$, $\bar{R}^2 = 0.66$, SEE = 0.33289, F = 36.16, DW = 1.719, and MAPE = 0.0278, where

ln SQFT= natural log of total square footage of residential housing constructed in Memphis and Shelby County
ln TNSQFT= natural log of total square footage constructed in the state of Tennessee
ln SQFT1= natural log of SQFT lagged one period
ln AAA1= natural log of triple A corporate bond rate lagged one period

THE COST FUNCTIONS

$$REALCV = -21105.02 + \underset{(1.9178)}{25.32236} SQFT - \underset{(0.00021)}{0.001838} SQFT^2 + \underset{(33.9525)}{133.7503} CONCOST$$

$R^2 = 0.88$, $\bar{R}^2 = 0.87$, SEE = 6631.23, F = 123.41, and DW = 1.70

$$\ln REALCV = 3.3320 + \underset{(0.0415)}{0.78236} \ln SQFT + \underset{(0.6726)}{0.25429} \ln CONCOST$$

$R^2 = 0.88$, $R^2 = 0.87$, SEE = 0.158, F = 189.24, and DW = 2.0, where

REALCV= real total contract value after adjusting for inflation
SQFT= total square footage constructed, Memphis and Shelby County
CONCOST= a cost index of construction materials, 1967 = 100

(Continued on page 15)

OPERATIONAL PROBLEMS OF SMALL BUSINESSES IN THE MID-SOUTH

*Satish Mehra**

All business organizations, large and small, face a variety of problems in today's competitive and dynamic business environment. Large businesses have the resources to study new concepts and ideas and to forcibly push for the success of those that prove feasible. Support for expensive and elaborate programs of testing, marketing, and improving products and services comes from a battery of well-financed executives and consultants. Occasional failures in the development of new ideas generally have a little impact on the smooth functioning of big businesses. Unfortunately, for small businesses, even a minor failure can totally disrupt the company.

An extremely common problem in small business operations is lack of knowledge. From the very beginning of an idea through its evolution to the final stages of implementation, much information is needed. Whatever the business, feasibility studies and comprehensive plans are necessary to tranform ideas into reality. A well-prepared feasibility study contains at least four major sections: marketing; management; accounting, financing, and taxes; and legal aspects. The small business owner needs to analyze economic conditions, possible sales, and required expenses to determine the potentials for success.

Business problems may range from minor bookkeeping mishaps to major crises that threaten business survival. Unlike a big business, a small business cannot afford to finance an elaborate program for investigation of its problems. What resources for assistance and information are available for small businesses?

A potential resource for small businesses is the local Chamber of Commerce, Small Business Administration (SBA), or a similar state or city agency. Such agencies provide support and guidance for the welfare of small businesses in their territory. The numerous publications and services available to small businesses through the local Chamber of Commerce can provide the assistance needed to solve problems and the information needed for feasibility studies.

This article describes the results of research conducted to explore, on a pilot basis, the operational problems of small businesses in the Mid-South area and to ascertain the extent to which these businesses have sought assistance from the Memphis Area Chamber of Commerce or a similar local agency. Specifically, the study was conducted to develop a data base consisting of operational problem areas, timing at which these problems occur, and opportunities for providing training programs to assist small businesses. An additional objective of the study was to forecast areas in which assistance will be sought in the coming years.

Research Methodology

The research methodology involved the use of a questionnaire to collect data on various factors concerning the day-to-day operation of a small business. Prepared and validated with the assistance of a Chamber of Commerce officer and small businessmen not directly involved in the study, the questionnaire was administered by mail to respondents representing 120 randomly selected small businesses in the Mid-South. The response rate of usable questionnaires was approximately 58 percent. A cross-section of respondents indicates that a variety of businesses were involved in this study:

Retail Trade	22%
Construction	11%
Manufacturing	19%
Service	28%
Automotive	5%
Finance, Insurance, and Real Estate	5%
Transportation	7%
Other Miscellaneous	3%

The typical respondent was either the owner of the business or the president/general manager of the organization. Half of the responding businesses had been in existence anywhere from 1 to 10 years and employed approximately 50 persons.

The study was divided into six topical areas in terms of analyzing the operation of small businesses. The article, therefore, is organized according to the same six areas or operating factors:

1. Major problems encountered by small businesses
2. The most serious problems encountered
3. Life-cycle analysis, i.e., when in the life of a small business major problems are encountered
4. Current state of affairs in operating small businesses, i.e.:
   a. Latest developments in small business management
   b. Use of computers
   c. Export opportunities
5. Need for training programs for the operating of small businesses

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**Associate Professor, Department of Management, Memphis State University, Memphis, Tennessee.*

6. Small business vis-a-vis Chamber of Commerce utilization

Data were collected on these six operating factors by means of the questionnaire. The results were tabulated according to simple frequency procedure and are described below.

Major Problems Encountered by Small Businesses

It is known quite well that all businesses encounter problems in their day-to-day operation, and small businesses are by no means an exception. In fact, small businesses typically face more problems that require outside help than do large businesses. To determine the kinds of problems requiring outside help, the questionnaire included a list of 17 major problem areas and provided space for three more to be added by the respondent. Respondents were asked to check all of the problem areas that they considered pertinent to their respective businesses. From a final tally, a list of 10 most commonly cited problems requiring outside help was prepared. These problems are presented in Table 1 in order of their seriousness to small businesses.

Table 1

MAJOR PROBLEMS ENCOUNTERED BY SMALL BUSINESSES

Working capital	41%
Accounting/bookkeeping records	35%
Forecasting demand for your product and/or services	33%
Financial planning and use of financial information and ratios	33%
Banking/finance	33%
Legal problems/information	31%
Sales/marketing	29%
Credit and collections	29%
Advertising of your product/services	28%
Overall business organization	21%

Accounting and other money-related functions seem to be of major concern. This is not surprising, since the cost of money is high at present. Interestingly, it is not only the cash flow that is creating trouble, but also the managing of money-related matters. This is evident by the fact that many small businesses seem to have problems with using financial information and ratios. Making predictions of the demand for goods and services is another problem area mentioned frequently. Forecasting problems, however, may be caused by problems in advertising and promotion, since this is another frequently mentioned problem area for small businesses.

Legal problems and information on legal matters also appears on the list of 10 major problem areas, along with overall business organizational matters. To some degree these two areas are related to each other, but generally the problem seems to be in terms of coping with a large amount of bureaucratic functions, such as legislative compliance. Finally, credit and collections is another area of concern found in this study. This can be explained by the failure of small businesses to set up proper credit and collection procedures. Small businesses may be extending credit flexibility to attract clientele and then may encounter difficulties in making collections.

Additional problem areas cited by the respondents include:

1. Long-range planning—trying to establish direction in a rapidly changing environment
2. Federal funding services—for a public agency
3. Attracting suitable management
4. Solving federal regulatory problems
5. Conflicting government regulations—federal versus state EPA, etc.
6. Accounts receivables
7. Proper ratio of service and clerical personnel to production personnel and business volume; employee turnover
8. Insurance
9. Tax theory

Most Serious Problems

The study attempted to narrow down the problem areas by asking participants to list the three most serious problems encountered by their businesses. Table 2 presents the five most serious problems in order of their frequency (from highest to lowest) as seen by respondents.

Table 2

MOST SERIOUS PROBLEMS ENCOUNTERED BY SMALL BUSINESSES

Working capital	33%
Financial planning and use of financial information and ratios	26%
Banking/finance	26%
Legal problems/information	21%
Credit and collections	21%

A comparison of Tables 1 and 2 shows once again that small businesses regard capital and other money-related matters as the most serious problem area. Therefore, one conclusion of this study is that a comprehensive training program is needed to assist small businesses in proper planning of their financial resources, especially during the present tight monetary situation. Also mentioned as a very serious problem is the area of legal matters and legal information. The frequency of this response may be because of the vast amount of paperwork that small businesses have to deal with in order to satisfy various government agencies. It is recommended that the Chamber of Commerce or a similar agency provide intensive seminars on topics such as "Legal Environment for Small Businesses" for people planning to start up a small business.

Life-Cycle Analysis

Following a consideration of the kinds of problems encountered by small businesses and the seriousness of these problems as perceived by the respondents, the study sought to determine when in the life cycle of small businesses such problems are encountered. The life cycle of a business can be divided into at least three stages.

Participants were asked to indicate when in terms of life-cycle stages they encountered serious problems. Table 3 presents the findings for this section, showing that a large majority (74 percent) run into problems after having reached a steady state, i.e., when the business is in full operation. Only a small proportion, about 20 percent, encounter any serious problems in starting a business.

Table 3

LIFE-CYCLE ANALYSIS: STAGE DURING WHICH SERIOUS PROBLEMS ARE ENCOUNTERED

Stage I: When starting the business	21%
Stage II: Business was in steady state or full operation	74%
Stage III: Business was losing substantially	7%

These findings indicate that although it may not be very difficult to start a small business, poor organization and a lack of proper planning may result in problems appearing in the second stage of the small business life cycle. In other words, if careful planning and good organization go into starting a small business, chances are that it will not face many problems in later stages of its operation. This suggests the necessity of some kind of a program, sponsored by the Chamber of Commerce, SBA, or another agency, to provide an in-depth look at what is involved in starting a small business. It is imperative that entrepreneurs be totally aware of what they are getting into in terms of the small business environment. It becomes critical given the fact that minor imbalances for small businesses can cause a speedy move into the final stage of a business—Stage III, the terminal stage.

Current State of Affairs

Staying current with the latest developments in the field is essential for a progressive business. For a small business, it can be difficult and expensive to try to stay abreast in terms of managing techniques that relate to the organization. Therefore, this study included an investigation of whether participants feel that they are able to keep up with the latest developments, and if so, what sources of information they use. Two further aspects were examined in the same section of the questionnaire: the use of computers and knowledge of export opportunities. Table 4 provides a summary of the findings.

Two-thirds of the respondents reported that they are able to keep up with the latest developments in managing small businesses. This means, however, that over 30 percent are not able to keep in touch with what is happening in their field. Some of the small businesses may not even be aware of the information available that might be pertinent to their operation. This indicates the existence of a problematic situation concerning the availability and dissemination of information for use by small businesses.

Table 4

CURRENT STATE OF AFFAIRS IN SMALL BUSINESSES

Are you able to keep up with the latest developments in managing small businesses?	*yes* 66%	*no* 34%
If yes, what is your source of information?		
Business magazines		21%
Trade associations		14%
Industry meetings and seminars at state and national level		14%
Trade journals		10%
Newsletters		5%
Books		3%
Wall Street Journal		3%
Other sources:		
Memphis Chamber of Commerce	Local consultant	
Prentice-Hall Treasurer's Report	Small Business Report	
Auditing firm	The AIA	
Extension courses	Daily newspapers	
U.S. Federal Register	Very well informed president	
Are you currently using a small computer in your company?	*yes* 51%	*no* 49%
If yes, is it your own?	*yes* 72%	*no* 28%
If you are not using a computer, do you plan to use a small computer in your business?	*yes* 61%	*no* 39%
Are you aware of any opportunities for export of your products to other countries?	*yes* 20%	*no* 80%
If no, would you like to find out about such export opportunities?	*yes* 50%	*no* 50%

There seems to be no one single source of information for small businesses. From the extensive list in Table 4, it is evident that a variety of magazines, journals, and newsletters are published to provide the information needed by a small business entrepreneur. This finding suggests that the publication of a community/area business journal or newsletter to promote effective small business management and summarize the current information from a variety of fields would go a long way toward assisting small business operators.

On the other two aspects, computers and export opportunities, the questionnaire elicited a mixed response. Half of the respondents are using a small computer at present, and among these users, a large majority own their computers. Among the non-users, a majority of the respondents plan to use computers in their operations in the near future. This clearly shows an increasing trend among small businesses toward adapting to a computerized operation as small computers become less expensive and more readily available.

Concerning export opportunities, a vast majority of the respondents (80 percent) indicated total unawareness of export possibilities for their goods and services. Furthermore, when asked if they would like to find out about export opportunities, about 50 percent of this group responded negatively. This response suggests that some of the participants involved in this project believe that their products or services are not exportable. However, 50 percent indicated a desire to receive information on export opportunities, which implies that a need exists for the dissemination of information on overseas business for small organizations. The business newsletter suggested above could also be used to provide information on computers and their use and export/import-related information for small businesses.

Training Programs

Continuous training of managers in any business is essential in this age of rapidly changing technology. Therefore, this project explored the possibility of providing training programs for small businesses.

The participants were asked to indicate the specific areas in which they would like to see training programs or seminars established for small businesses. The questionnaire listed a variety of training areas where small businesses could benefit. Table 5 records the top five responses to this section of the questionnaire. The top five areas mentioned represent the basic functional areas of a business. Weakness in these areas will generally weaken a business organization. It is recommended that agencies and other groups or individuals make use of the contents of Table 5 in designing training and assistance programs for small business entrepreneurs.

Table 5

TOP FIVE TRAINING PROGRAM NEEDS

General management for small business	60%
Personnel training	35%
Sales/advertising	35%
Accounting for small business	33%
Use of small computers	28%

Chamber of Commerce Utilization

An important objective of this study was to examine the role that a chamber of commerce (in this instance, the Memphis Area Chamber of Commerce) can play in providing assistance to small businesses. Three aspects of Chamber of Commerce utilization were considered in this section of the study.

First, the study examined the level of public awareness of Chamber of Commerce programs for solving small business problems. A substantial majority of the respondents (66 percent) indicated awareness of the fact that the Chamber of Commerce provides assistance in solving problems encountered by small businesses. However, very few of the businesses, only about 12 percent, have actually utilized the services of the Chamber of Commerce. Of the businesses seeking assistance from the Chamber of Commerce, all were very satisfied with the services. Thus, it is recommended that the Chamber boost its campaign to promote the services it provides for the welfare of small businesses.

Second, this study attempted to locate the time span in the life cycle of a small business when assistance was sought from an outside agency. It was found that over two-thirds of the businesses seek help in the second stage (business running in full operation) of their life cycle, while only about 21 percent turn to outside help during the first stage, i.e., when just starting the operation. This is exactly in line with the information documented earlier in this article, in the life-cycle analysis section. Again, one can conclude that lack of proper assistance in the earlier stages of a small business will create problems in some later stages of its operation.

Finally, information was gathered from the participants in this project as to where they go for assistance, if not to the Chamber of Commerce. As Table 6 shows, there is no single source from which small businesses seek assistance. Sources range from banks, consulting firms, and trade associations, to private individuals such as lawyers and accountants. This suggests that the formation of a unified assistance agency could reduce duplication of effort and direct small business individuals/groups to the most effective resources for assistance.

Table 6

CHAMBER OF COMMERCE AND SMALL BUSINESS ACTIVITIES

Are you aware that the Memphis Area Chamber of Commerce provides assistance toward solving problems encountered by small business?	*yes* 66%	*no* 34%
Have you ever utilized services of the Memphis Chamber to help solve your business problems?	*yes* 12%	*no* 88%
If yes, were you satisfied with the help you got from the Chamber?	*yes* 100%	*no* 0%
At what stage did you seek help from the Chamber or any other agency?		
Stage I: When starting the business		21%
Stage II: Business was in steady state or full operation		68%
Stage III: Business was losing substantially		3%

Other agency you sought help from:
- Bank
- Management consultant, accountant, lawyer
- Consulting firm
- National Pharmaceutical Association
- Small Business Administration
- Dun & Bradstreet on collections, plus local attorney and insurance professional
- Independent consultant

Conclusion

This pilot study attempted to analyze operational problems of small businesses in the Memphis and Mid-South region. Also considered was the role of the Chamber of Commerce in assisting small businesses. The data base developed by this study will, it is hoped, contribute toward the ongoing effort to assist small businesses in solving their operational problems. The findings indicate, in general, the kinds of problems small businesses encounter and the kinds of information and training that exist or could be provided by the local Chamber of Commerce. Future research should concentrate on specific problems of a particular industry or a particular problem faced by a variety of businesses.

CENTS-OFF COUPON USAGE IN MEMPHIS

*John R. Thompson and Peter K. Tat**

The distribution of cents-off coupons offering customers a reduction in the regular purchase price has become an important element in the promotional mix for most consumer package goods as well as an ever-increasing range of other products and services. Although coupons have been utilized since the end of the last century, there has been a rapid increase in their use since 1970. At the beginning of the decade it was estimated that manufacturers distributed 16.4 billion coupons, but by 1979 this number had increased more than fourfold to an estimated 80 billion. It is estimated that about 90 billion were distributed by manufacturers in 1980. The total number of coupons made available to consumers is actually much greater, because this estimate is only for coupons distributed by manufacturers and does not include the billions distributed annually by retailers through their weekly newspaper advertisements.

The apparent success of coupons in achieving marketing objectives has led to their use by an increasing number of companies. Many of these are outside the food/household products and toiletries categories traditionally associated with coupons. Some notable examples include automobile dealers and manufacturers, appliance manufacturers, and the fast-food industry. In 1979, the airline industry launched what were probably the most expensive coupon programs ever. These were the half-fare offers by United, American, and other companies which saved consumers millions of dollars in reduced air fares.

The expanded use of coupons has met with criticism from some consumer activists and government officials.[1] In general, these critics recognize and admit that individual consumers can save on individual purchases by using coupons. However, they argue that the total cost of coupon programs exceeds the amount that consumers save and therefore adds unnecessary costs to the consumer's overall bill for food and other products. The argument is based on the overall low redemption rate of coupon programs (5 percent) and the high rate of improperly redeemed coupons (20 percent). It has been suggested that the coupon system could be eliminated and the price of all products reduced accordingly. Under these circumstances, the occasional use of special sales has been proposed as being a more effective way to draw attention to new products and attract new customers.

Perceived Consumer Benefits

There is no doubt that many consumers are strong supporters of couponing. The increased distribution of manufacturers' coupons has been accompanied by a substantial increase in the proportion of households that report coupon usage. A 1977 survey by the U.S. Department of Agriculture found that 80 percent of all households reported that they saved and used coupons, up from only 58 percent in 1971.[2] A. C. Nielsen reported that 76 percent of all households use at least some coupons.[3] Although usage rates tend to be higher among middle-income households and families that spend the greatest amount on food, coupons are used by all demographic groups.

The reason for the extensive usage is simply the price reduction offered directly to the consumer. The extent to which the consumer saves is in direct relation to the amount of time she or he is willing to spend collecting and filing coupons. One woman who devotes considerable time to the task reported saving 40 to 60 percent everytime she shops, for an average saving of $40 per week.[4] Another woman makes 80 percent of her shopping purchases with coupons she has obtained from both regular coupon vehicles and coupon refunds. She also has set up a national organization with its own newsletter to help others.[5]

Coupons also offer the consumer a highly flexible form of saving that can meet the needs of most households. Most coupons are valid for many months, which allows consumers to use them to reduce the price on products they actually need at the time they are required. Taking advantage of weekly specials of sales often means stocking up on items that may not be immediately used, which may lead to wastage.

Manufacturers' coupons can also be used at virtually any store that stocks the product. This maintains the consumer's freedom of choice and allows shopping at the most convenient or preferred retail outlet without the costs, time, and effort involved in traveling to several retailers in order to realize the same savings.

The savings available from coupons have become important to consumers as inflation and other factors have forced food prices up by over 75 percent in the past eight years. Consumers see coupons as a valuable ally in their struggle with inflation. In a survey undertaken by *Progressive Grocer* at the beginning of 1979, 63 percent of the respondents reported that they had increased their use of cents-off coupons in order to reduce the impact of inflation. In the same survey, 83 percent of the respondents

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**The authors are, respectively, Professor and Assistant Professor, Department of Marketing, Memphis State University, Memphis, Tennessee.*

rated coupons as "important" in shopping economically. Along with the need to stay conscious of exact prices, the use of coupons was seen as the most widely used anti-inflation strategy.[6]

Coupons and the Marketing Mix of Manufacturers

Another important benefit of coupons perceived by consumers is that coupons help take the risk out of trying new products. Coupons are important in the introductory strategy for new products because they enable consumers to try new or different products at a substantially lower cost. Manufacturers also use coupons as an aid to induce consumers to buy older products that are not selling well or are being challenged by competitors.

One coupon critic has said: "The coupons' real value to manufacturers . . . is in persuading food retailers, rather than food shoppers, to buy their products."[7] Manufacturers' use of coupons to help push their products into the distribution system is especially prominent with new products, where retailers look for strong promotional support before they will consider stocking a product. A recent survey found that coupons were one of the most important components of introductory promotional programs and that products which were accepted were more than twice as likely to include an introductory coupon offer than were those products which were rejected.[8] As one executive noted: "The person who invented the cents-off coupon must have loved manufacturers, retailers and consumers alike. There is scarcely a more useful promotional tool in all of marketing."[9]

Coupons, when properly coded, can be a valuable research tool to the manufacturers. Product description, area code, and face value of the coupon can be coded to help the issuers identify the redemption rate of coupons (1) of different product class, (2) in various markets, (3) with different face values, and (4) by method of distribution. These data provide the manufacturer with valuable information about the product, its price, its appearance to the consumer, and the distribution problems.

Coupon Usage in Memphis

In pilot studies to examine the phenomenon of coupon usage in Memphis, telephone surveys were conducted in late Autumn, 1980. Families residing in middle- to upper-income areas were chosen randomly for the study. This survey resulted in a total of 370 usable interviews. Additional interviews were conducted in the spring of 1981 in low-income areas. Low-income families are reputed to be light users of coupons. This second survey resulted in a total of 275 usable interviews.

Respondents were asked to answer questions concerning the use of coupons, couponing behavior, and demographic characteristics. The two groups were further divided into the light, medium, and heavy users of coupons according to the reported usage of coupons per shopping trip. Users of one to four, five to ten, and more than ten coupons per shopping trip were grouped into the light user, medium user, and heavy user category, respectively. As shown in Tables 1 and 2, a smaller proportion of consumers with lower incomes use coupons; however, those who do use them redeem more coupons per shopping trip.

Table 1

REPORTED USAGE OF COUPONS

	Mid-Upper Income		Lower Income	
	Number	Percent	Number	Percent
Yes	324	88	203	74
No	46	12	72	26
	370	100	375	100

Table 2

NUMBER OF COUPONS USED PER SHOPPING TRIP

	Mid-Upper Income		Lower Income	
	Number	Percent	Number	Percent
1-4 (light)	182	56	75	37
5-9 (medium)	105	32	99	48
10 or more (heavy)	36	12	30	15
	323	100	204	100

Table 3 presents the sources of coupons reported by the respondents. The newspaper is the major source of coupons for both groups. Although in/on package is a popular medium for coupon distribution, respondents in these studies did not report this medium as a source of coupons. Moreover, direct mail is not seen by the respondents as a major source of coupons. However, mailed coupons have been found to have the highest redemption rate, surpassing newspaper and magazine coupons.

Table 3

SOURCES OF COUPONS
(Responses in Percentages)

Coupon Sources	Lower Income	Higher Income
Newspaper	76	61
Magazine	1	2
Direct Mail	3	4
Wherever I find	5	7
More than one source	16	26
Total	100	100

As may be expected, lower-income users spend more time clipping coupons. Some 10 percent of all low-income respondents reported that they spend more than two hours each week clipping coupons. For higher-income families, the corresponding figure was 3 percent (See Table 4).

Table 4

WEEKLY TIME SPENT ON COUPON CLIPPING

(Responses in Percentages)

Time Spent	Lower Income	Higher Income
Less than 1 hour	80	89
1 to 2 hours	9	9
2 to 3 hours	7	2
3 to 4 hours	3	1
Total	100	100

If the purpose of using coupons is to save money, the extent of such usage should be related to the amount of money saved per shopping trip. The data in Table 5 suggest that such a relationship exists. Almost one-fourth of all low-income respondents save more than $5 per shopping trip. This compares to 11 percent of the higher-income respondents.

Table 5

MONEY SAVED BY USING COUPONS

(Responses in Percentages)

Money Saved		Lower Income	Higher Income
Less than	$1.00	11	19
$1.00 to	$1.99	11	24
$2.00 to	$2.99	31	23
$3.00 to	$3.99	16	16
$4.00 to	$4.99	7	7
More than	$5.00	24	11
Total		100	100

About half of all higher-income respondents indicated that they used more coupons in 1980 than in 1979. However, more than 54 percent of the lower-income respondents indicated more usage of coupons in 1980 (see Table 6).

Table 6

GREATER COUPON USAGE IN 1980 THAN IN 1979

(Responses in Percentages)

Response	Lower Income	Higher Income
Yes	54	49
No	24	28
Same	21	23
Total	100	100

When asked if coupon redemption policy is a patronage motive for particular stores, more of the higher-income respondents indicated such policy is a determinant factor (see Table 7). A larger majority of the low-income group of users indicated that they do not shop at a particular store because of the store's coupon redemption policy.

Table 7

COUPONS AS A PATRONAGE MOTIVE

(Responses in Percentages)

Response	Lower Income	Higher Income
Yes	27	61
No	61	57
All stores are the same	12	5
Total	100	100

Conclusions

Survey results reported here substantiate the findings reported earlier in this article, except Memphis area shoppers are even greater coupon users. These little pieces of paper are viewed as valuable by both higher-income (upper and middle) and lower-income shoppers. The benefits of coupons in the distribution system are seen in the dramatic growth in coupon distribution, which indicates that manufacturers see coupons as a powerful and efficient promotional tool for introducing new products and building sales of their current line. Retailers also gain from additional customers and increased sales as well as the revenue from a handling allowance. Consumers are turning to coupons to offset the inflationary pressures impacting their grocery shopping, and this is reflected in their ever increasing use of coupons. Thus, coupons are likely to continue to be a valuable marketing technique for the foreseeable future.

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[1] "Value of Coupons Debated at Food Editors Conference," *Editor & Publisher*, June 21, 1980.

[2] "Coupon Use in Food Marketing," *National Food Review*, April 1978, pp. 12-14.

[3] *Memphis Commercial Appeal*, Dec. 3, 1980, p. 35.

[4] "Cashing in on Coupons," *Time*, Sept. 3, 1979, p. 51.

[5] "Coupon Queen Fights Inflation," *Los Angeles Times*, Nov. 18, 1979, part IX, p. 11.

[6] "Annual Report to the Grocery Industry," *Progressive Grocer*, April 1979.

[7] William Nigut, Sr., "Is the Boom in Cents-Off Couponing Going to Burst?" *Advertising Age*, Dec. 15, 1980, p. 41.

[8] "New Item Seller Meets New Item Buyer," *Progressive Grocer*, November 1978, pp. 57-58 and 60.

[9] "Coupons—The Choicest Cut of All," *Business Week*, Oct. 6, 1975, p. 55.

EMPLOYMENT AND TRAINING PROGRAMS AND TRIAGE

*Haskel D. Harrison and Michael S. Lane**

> *The fastest growing, most critical industry for the next decade is training . . . . Training has to keep pace or people will be lost in the Third Wave.*
>
> —Alvin Toffler, in a recent speech before the American Society for Personnel Administration

It has been a critical year for the Memphis economy. Three major employers in Memphis have announced or initiated plant closings. In addition, a number of Memphis firms have laid off significant numbers of employees. The impact of these layoffs and closings on the economic base of Memphis indicates the need for a reevaluation of the mechanisms that the private and public sectors use to respond to the problem of training and/or retraining personnel for unsubsidized employment. The problem has been further exacerbated by a significant reduction in the availability of public training funds.

The Memphis response to these problems requires a selection process for training that maximizes the utility of the expenditure of public monies as well as the impact of training. This article presents such a system, using a technique developed by the medical profession for the classification of large numbers of patients in emergency situations.

This medical assignment procedure is called *triage.* Triage is a method for classifying casualties and providing first-aid. Typically, mass trauma treatment falls within three categories. First, there are those who have suffered severe injuries, with a maximum probability of death. They are simply made as comfortable as possible. Second, there are those with injuries that have the least possibility of resulting in death. They are also made as comfortable as possible. The third group—individuals whose survival depends upon treatment—receive immediate and complete attention. The triage is, then, a system for categorizing the nature of the injury in order to provide treatment. Treatment depends upon the availability of resources, the number of patients, the severity of the injury, and the likelihood of response to treatment.

Edelwich and Brodsky[1] suggest that current economic contingencies have fostered a situation where future resources for human service programs will be allocated in a manner much like triage. This discussion will consider five issues that seem to have relevance to the situation:

1. What has been the traditional role of employment and training programs among antipoverty programs?
2. How can that role be anticipated to change?
3. What part does the issue of "creaming" play in the current situation?
4. Does the triage procedure have application in employment and training programs?
5. What are the policy implications of triage?

Employment and Training Background

Historically, manpower policies and training programs have been crisis-reactive in nature. The process has been traditionally rooted in a current economic milieu. Frequently, this has meant that policies and programs have been formulated in a haphazard, inconsistent, short-range manner to meet the immediate contingencies fostered by changes in both the social setting and the economy. Hence, the initial goal of providing employment and training services to prepare individuals "most in need" for participation in the labor market has been greatly enhanced to include a complex set of social policies to accompany the attack on "structural unemployment." The diverse mission of manpower policies and programs was summarized by E. Wright Bakke in 1969:

> A manpower policy's . . . objective is a system of full particularized employment which is maximally productive, economically rewarding and dependable for workers and employers, national and individual growth-stimulating, and freely chosen. Its clientele is the total labor force now employed, to be employed, unemployed, underemployed, or ineffectively employed, whatever their type and degree of skill, industrial or occupational attachment, or condition of social or economic advantage or disadvantage.[2]

In practical terms, this has meant that employment and training policies were destined to fail. No single program or set of programs can be "all things to all people" and still keep the taxpayers satisfied. Unfortunately, employment and training has been required to adopt this stance and has suffered highly publicized criticism when it has recorded minimal successes. The 20-year history of the "manpower movement" is replete with examples of the frustrations resulting from a constantly expanding role and focus.

In 1962, the Manpower Development and Training Act (MDTA) was passed to meet the special needs of displaced workers. MDTA trained or retrained workers who had been displaced through economic or technological changes. Since that time, MDTA evolved and was eventually subsumed within the Comprehensive Employment and Training Act (CETA). Consequently, those early, rather straightforward charges were expanded to include myriad activities:

1. Efforts to recruit, train, and find employment for participants and help maintain them in their jobs
2. Human services support to include income supplements, transportation allowances, child care, employability planning, personal counseling, training for prison inmates, etc.

**The authors are, respectively, Senior Research Associate and Research Associate, Center for Manpower Studies, Memphis State University, Memphis, Tennessee.*

3. Traditional vocation or academic education that was not delivered through school systems or boards of education
4. Job search training, reduction of traditional employment barriers, formalized labor market information systems, job choice mechanisms, etc., and vocational skills training in innumerable areas
5. Precollege and CETA work-study college programs
6. Affirmative action, which attacked protected jobs restricting ports of entry for low-level workers
7. Program coordination among CETA operations, community-based programs, subcontractors, and subgrantee service providers
8. Revenue sharing to help restore local control over programs and allocations
9. Targeting special groups for recruitment, training, special programs, and placement, including migrant workers, Native Americans, inmates, youth, displaced homemakers, Vietnam era veterans, Vietnamese immigrants, etc.
10. Improving the ability of entry-level workers to follow shifts in the economy, and training individuals to meet economic growth areas outside their local residences

The "comprehensive" term in the CETA acronym becomes obvious.

This partial list of expanded manpower activities suggests the service delivery complexities that employment and training program operators have come to face. With appropriate funding levels, employment and training programs could, in the main, at least address those areas. However, funding cuts will restrict the scope of employment and training activities and will foster a reexamination of the services offered by employment and training programs in order to determine how resources may be most effectively and efficiently utilized. Although triage has been most commonly used to describe the system of allocating emergency medical treatment, the first definition of this term in fact referred to the grading and systematic assignment of products for market. Employment and training administrators have readily recognized that the output from their system is the participant. In effect, the participants are the product of employment and training services. New restrictions resulting from declines in funding levels make it necessary to develop a product grading system, or a procedure for determining which employment and training applicants have the greatest potential for economic survival.

The Issue of Creaming

Basically, "creaming" has been described in manpower literature as the process by which participants who have the most likely chance of success in a program are selected over individuals who may possess fewer success-related qualities. Traditionally, those selected would be individuals who possess the attributes generally agreed to correlate in some fashion with "success." Those attributes may be a particular education level, age, and maturity, close attachments to the labor market, close ties to the traditional family structure, stable work experiences and histories, and more mainstream activities, more skills, and fewer barriers to employment than individuals not selected for participation.

Manpower programs have characteristically avoided any appearance of creaming, because it has been viewed as being discriminatory. However, when the applicant pool available for programs is greatly expanded—typically during periods of high unemployment—the least educated, skilled, experienced, credentialed, etc., tend to be pushed to the back of the queue. This means that the individuals most likely to be successful in the CETA program are pushed to the front of the queue and are selected from the program applicant pool. This is how creaming may take place in a CETA program.

Another form of creaming may result from program operators responding to pressure from superiors for improved performance indicators, in the form of increased placements and positive termination rates from the program. In terms of cost-benefit considerations, creaming is clearly advantageous, but it has typically had a negative connotation because it necessarily assumes exclusionary characteristics. Obviously, if one person is accepted for enrollment in a program, another is simultaneously rejected. Selectivity of any type is exclusionary in nature. In effect, strong informal sanctions have discouraged the appearance of applicant creaming among employment and training program operators.

Consensus and Reality

Manpower programs have rarely repudiated "outside" criticism because, as a review of the manpower literature reveals, manpower professionals have rather consistently been among the most vocal critics of employment and training programs. In the face of mounting criticism, however, there have been few substantial changes in employment and training programs since the inception of CETA in 1973. Changes have typically been short-range responses to changes in the economy. However, the economy has unfortunately stabilized, and the realities of "stagflation" have promoted rethinking of the public policy related to CETA. As Sorrenson[3] rightly perceived, public policy is simply a determinant of "who gets what" in society.

By 1977, in anticipation of limited resources, more conservative economists recognized that "a comprehensive restructuring of our vast array of social programs is our best hope for solving the inflation problem."[4] CETA is likely to be primary among the programs that are restructured. In fact, in 1980 CETA prime sponsor administrator Dr. John Mori proclaimed that CETA was dead: "What people perceive as life signs, are really the spasms and convulsions of a program that has become extinct."[5] Elsasser recognized that the current CETA emphasis on the "hardest of the hardcore unemployed" causes exponential cost increases. He noted that "it is

MID-SOUTH ECONOMY

BUREAU OF BUSINESS & ECONOMIC RESEARCH THE FOGELMAN COLLEGE OF BUSINESS AND ECONOMICS MEMPHIS STATE UNIVERSITY

STATISTICAL SUPPLEMENT

THE MID-SOUTH ECONOMY

The Mid-South economy showed little sign of improvement in the third quarter of 1982. Forecasts for a national economic recovery are being revised downward, with the starting date being pushed forward and the estimates of its size and strength being reduced. *Business Week* stated in its forecast for the next 18 months that "U.S. business is battening down for a protracted period of slow growth and sluggish activity." The National Federation of Independent Business reported that "small companies indicate they will neither hire labor nor build inventories in anticipation of recovery. They say they will have to see the demand before they act." On the consumer front, according to the Institute of Social Research at the University of Michigan, "despite the continued low rate of inflation, consumers have lost confidence in overall government policies due to the increases in unemployment and they hold less favorable expectations for future improvement in business conditions."

Additionally, agriculture continues to be caught in a classical squeeze condition. On the one hand, the index for prices received by U.S. farmers stood at 135 in August 1982, down three index points from last August. On the other hand, the index of prices paid for commodity services, interest, taxes, and wages stood at 151, some five index points higher than last August. And farm loan delinquencies in the nation reported by the Farmer's Home Administration were 27.0 percent in June 1982. The rate in Louisiana was highest in the Mid-South, at 40.0 percent, followed by Mississippi with 36.0 percent, Alabama at 34.0 percent, and Tennessee with 27.0 percent.

Total personal income in the Mid-South rose 7.8 percent in the first quarter of 1982 from the same period in 1981, underperforming the national increase of 8.2 percent. Sales tax collections across the Mid-South were mixed, with Alabama and Tennessee registering the best gains. With the pace of growth in income and tax collections slowing, the Mid-South economy faces continued sluggishness in business activity. However, with lower interest rates and continued declines in the inflation rate, a rise in consumer and business confidence could set the stage for a modest recovery.

Labor

The nation's civilian labor force totaled 112,526,000 in July 1982, up 1.6 percent from last July. The civilian labor force has grown about 1.8 million since the recession began last July, with nearly half of that increase occurring in the last few months. The number of persons unemployed was 11,036,000 in July 1982, an increase of 35.7 percent from a year ago. Non-agricultural wage and salary employment in the nation declined 1.7 percent from last July, primarily as a result of a seasonally adjusted drop of 7.6 percent in the manufacturing sector. Non-manufacturing employment was little changed from a year ago, with gains registered in trade, finance, and service categories.

The Mid-South aggregate unemployment rate stood at 11.9 percent in July 1982, substantially above the 8.6 percent rate of last July. The number of persons unemployed jumped 43.2 percent from a year ago to total 931,400 out of a total Mid-South civilian labor force of 7,811,500.

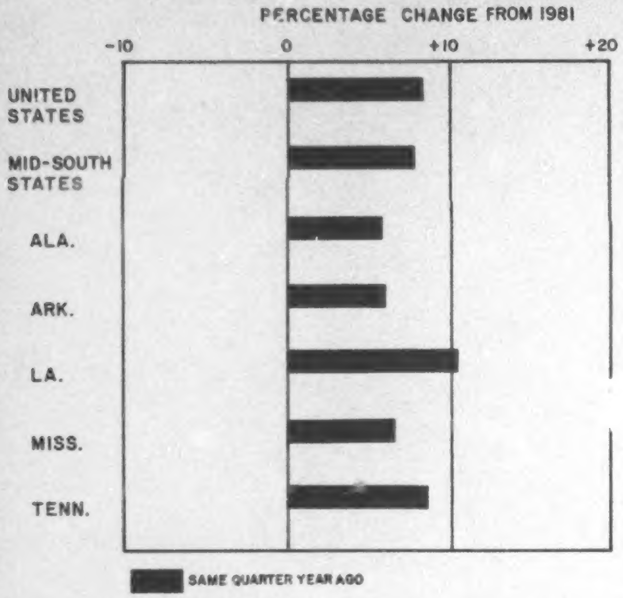
Manufacturing employment in the Mid-South totaled 1,410,100 in July 1982, down 6.9 percent from the level of a year ago. Losses were felt heaviest in non-electrical machinery (capacity utilization for this industry across the nation is about 63.0 percent), transportation equipment, wood and paper products, and textiles. Increases in the weekly and hourly earnings for production workers have slowed dramatically, while the number of hours worked registered declines. In terms of weekly earnings, the range of increases in July 1981 was 9.3 to 13.1 percent, with the increases for July 1982 in the range of 0.4 to 6.3 percent. Non-manufacturing employment increased by 14,100 jobs from last July, an increase of only 0.3 percent.

Construction

For the 12 months ending July 1982, the dollar value of total building permits issued was $82.9 billion, a decline of 17.5 percent from the same period in 1981. The number of residential permits fell 29.1 percent, with the dollar value of those permits dropping 28.9 percent.

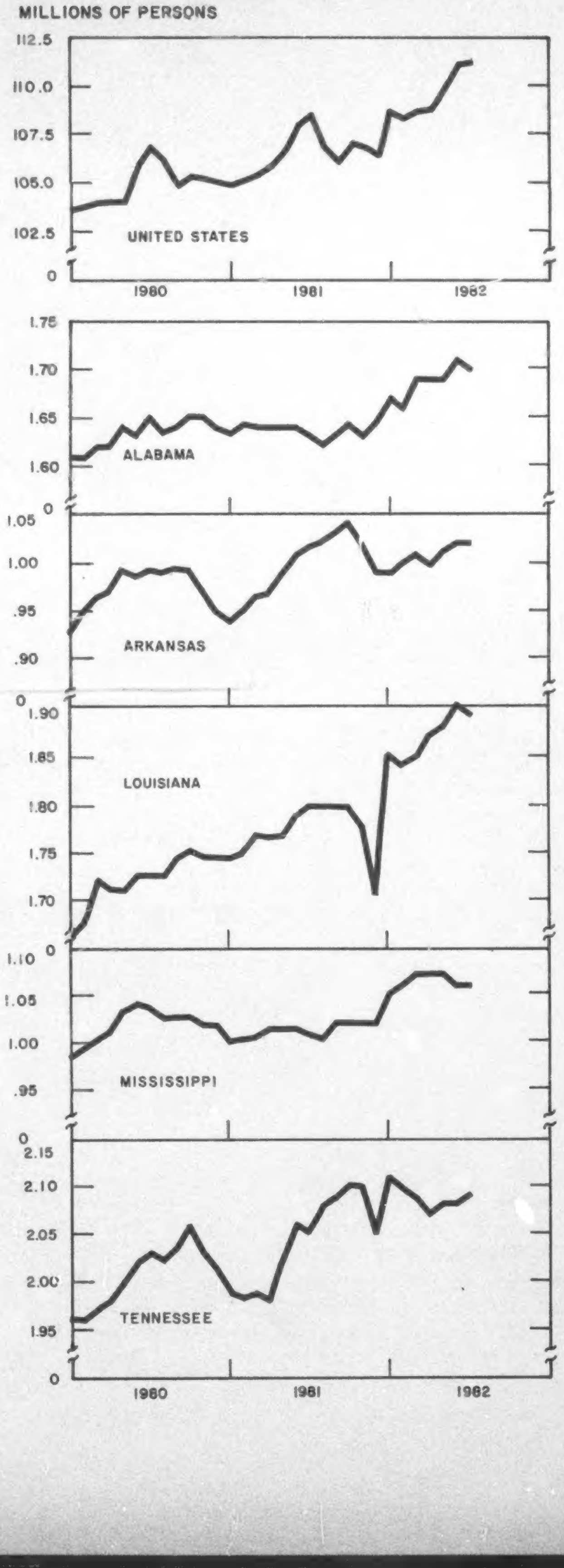
The dollar value of permits issued was down substantially across most of the Mid-South, with Tennessee

PERSONAL INCOME - I QTR 1982

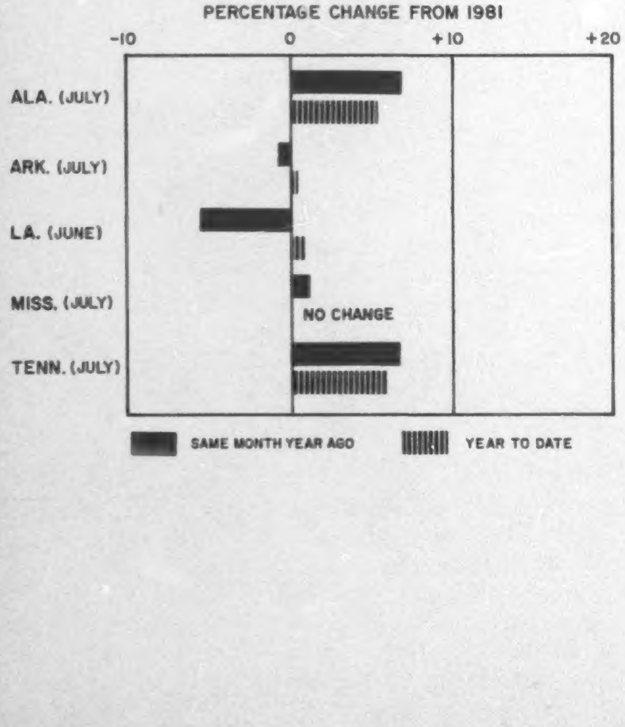


SOURCE: BUREAU ECONOMIC ANALYSIS

CIVILIAN LABOR FORCE



SALES TAX COLLECTIONS 1982



and Louisiana the only states to register positive gains in non-residential construction. For Louisiana, the gains were largest in stores and schools. For Tennessee the gains were concentrated in hospitals and offices.

Total dwelling unit permits for the year ending July 1982 were substantially down across the board, with Mississippi hit the hardest, issuing only 4,700 compared to 8,700 for the same period in 1981.

According to figures published by McGraw-Hill Information Systems, the cost per square foot for identical homes being built in some 100 market areas was $36.68 in August 1982. Costs for market areas in the Mid-South were $3.00 to $5.00 below this average.

Finance

Total deposits in the Mid-South for July 1982 advanced 12.6 percent from a year ago, just above the national increase of 12.4 percent. Demand deposits registered a substantial gain of 5.0 percent in the Mid-South compared to a 1.1 percent increase for the nation. Time deposits were up substantially across the board, helped along by declines in regular passbook savings accounts. Surprisingly, reports indicate some $160.0 billion is still tucked away in lower yielding passbook accounts, resulting in a loss of some $10.0 billion in interest payments.

Mortgage loans made in the Mid-South by savings and loan associations for July 1982 totaled $184.2 million, down 7.4 percent from last July. Arkansas was the only Mid-South state to register a gain. Net savings flow in the Mid-South registered a substantial turnaround. Net savings for July 1981 totaled a negative $115.6 million, while the total for July 1982 was a positive $54.6 million.

The October 12, 1982, issue of the *American Banker* listed Engle Mortgage Company of Birmingham, Alabama, as the largest mortgage company in the Mid-South. As of the end of June 1982, the Engle Company serviced 56,596 mortgages valued at $1.6 billion.

NOW accounts for July 1982 at savings and loan associations across the nation experienced substantial growth, up 76.7 percent from a year ago. However, the number of savings and loan associations in June 1982 totaled 3,586, down from 3,927 for June 1981.

LABOR July 1982	United States	Alabama	Arkansas	Louisiana	Mississippi	Tennessee
Civilian Labor Force	112,526,000	1,704,800	1,024,600	1,897,100	1,063,800	2,121,200
Percent Change Year Ago	+ 1.6	+ 1.9	- 2.1	+ 0.7	+ 4.4	+ 0.6
Unemployed	11,036,000	247,900	96,900	208,900	131,000	246,700
Percent Change Year Ago	+35.7	+34.9	+ 3.3	+26.7	+56.5	+30.6
Unemployment Rate						
1982	9.8	14.5	9.5	11.0	12.3	11.6
1981	7.3	11.0	9.0	8.8	8.2	9.0
Non-Agricultural Wage & Salary Employees	89,539,000	1,326,400	714,600	1,616,900	789,600	1,711,900
Percent Change Year Ago	- 1.7	- 2.1	- 2.9	- 1.3	- 3.6	- 1.5
Manufacturing Employment	18,839,000*	334,900	195,600	198,700	206,500	474,400
Percent Change Year Ago	- 7.6	- 8.2	- 8.8	-10.8	- 7.4	- 5.8
Non-Manufacturing Employment	71,004,000*	991,500	519,000	1,418,200	583,100	1,237,500
Percent Change Year Ago	- 0.1	+ 0.2	- 0.5	+ 0.1	- 0.1	+ 0.3
Average Weekly Earnings of Production Workers in Manufacturing	$332.60	$280.96	$261.58	$375.34	$244.22	$281.06
Percent Change Year Ago	+ 4.7	+ 0.4	+ 6.3	+ 3.8	+ 5.6	+ 4.6
Average Weekly Hours of Production Workers in Manufacturing	38.9	38.7	39.1	40.1	38.4	39.2
Percent Change Year Ago	- 1.8	- 2.7	- 0.3	- 4.3	- 1.0	- 2.0
Average Hourly Earnings of Production Workers in Manufacturing	$8.55	$7.26	$6.69	$9.36	$6.36	$7.17
Percent Change Year Ago	+ 6.6	+ 3.3	+ 6.5	+ 8.4	+ 6.7	+ 6.7

*Seasonally Adjusted.

Source: Departments of Employment Security and Survey of Current Business.

CONSTRUCTION[1] July 1982	United States	Alabama	Arkansas	Louisiana	Mississippi	Tennessee
Value of Construction						
Total Building						
Percent Change Year Ago	-17.5	-23.6	N.A.	- 5.8	-28.1	- 7.6
Residential Building						
Percent Change Year Ago	-28.9	-40.2	N.A.	-17.3	-42.9	-36.7
Non-Residential Building[2]						
Percent Change Year Ago	- 6.8	- 8.3	N.A.	+ 3.4	- 8.5	+24.2
Total Dwelling Unit Permits						
Percent Change Year Ago	-29.1	-39.2	N.A.	-14.9	-46.0	-34.1

[1] Twelve-month cumulative rate.

[2] Non-residential data excludes the cost of construction for publicly owned buildings.

Source: Federal Reserve Bank of Atlanta from data supplied by the Bureau of Census.

FINANCE July 1982	United States	Mid-South States	Alabama	Arkansas	Louisiana	Mississippi	Tennessee
Member Banks as of 7/7/82 Percent Change from 7/29/81							
Total Deposits	+12.4	+12.6	+ 9.7	+ 8.5	+14.7	+12.9	+13.4
Demand Deposits	+ 1.1	+ 5.0	+ 6.5	- 4.9	+ 5.2	+ 4.3	+ 6.7
Time Deposits	+20.7	+18.4	+16.8	+13.4	+22.3	+16.6	+18.2
Savings Deposits	- 2.2	N.A.	- 3.6	N.A.	- 0.2	- 2.6	- 3.3

Source: Federal Reserve Bank of Atlanta and the Federal Reserve Bank of St. Louis.

SAVINGS AND LOAN ACTIVITY July 1982	Alabama	Arkansas	Louisiana	Mississippi	Tennessee[1]
Mortgage Loans Made (millions)	$ 21.7	$ 60.4	$ 69.4	$ 8.9	$ 23.8
Percent Change Year Ago	- 15.9	+127.9	- 22.7	- 40.7	- 43.1
Percent Change Year-to-Date	- 42.2	+ 26.9	- 16.8	- 59.7	- 43.6
Net Savings Flow (millions)[2]	($ 16.1)	$ 1.6	$ 51.6	$ 2.9	$ 14.6
Percent Change Year Ago	+ 65.7	+104.9	+364.6	+806.9	+155.4
Percent Change Year-to-Date	+703.3	+349.7	+ 68.9	+288.2	+416.9

[1] Figures are for total loans made.

[2] Net savings flow equals new savings received plus dividends credited minus savings withdrawn.

Source: Federal Home Loan Banks of Little Rock, Cincinnati, and Atlanta.

THE TENNESSEE ECONOMY

The performance of the Tennessee economy in the third quarter of 1982 remained sluggish. While the metropolitan areas were showing signs of the beginnings of recovery, the rural areas remained deep in the grip of recession, primarily due to the weak farm economy and continuing declines in apparel and transportation equipment manufacturing employment.

Total personal income in Tennessee grew 8.5 percent from the first quarter of 1981 to the first quarter of 1982, outperforming the national increase of 8.2 percent. Farm income for the first quarter of 1982 registered a seasonally adjusted annual rate of $290.0 million, down 4.3 percent from a year ago. Non-farm wages and salaries increased 1.8 percent in the first quarter of 1982 from the fourth quarter of 1981, again managing to outperform the national increase of 1.3 percent. Much of this increase was due to a sharp jump in the wages of construction workers.

The Tennessee civilian labor force stood at 2,121,200 in July 1982, up only 0.6 percent from last July. Meanwhile, the number of persons unemployed jumped 30.6 percent to total 246,700, pushing the unemployment rate up to 11.6 percent. Non-manufacturing employment fell 5.8 percent. Losses were felt heaviest in non-electrical machinery, transportation equipment, apparel, and leather goods production. Once again, the biggest gains in non-manufacturing employment were concentrated in the service economy, up 19,000 jobs from last July. One bright spot was a report by the Tennessee Department of Economic Development which shows that for the first half of 1982 manufacturing investment in Tennessee totaled $309.1 million compared to $170.3 million for the same period in 1981. Seventy-five percent of this investment was directed to expansion of existing firms with the capital investment per job estimated at $97,794 compared to $64,296 last year.

Along with the fall in farm income, the index of prices received for all farm products in Tennessee stood at 129 (1977=100) in August 1982, unchanged from July 1982 and three index points below last August. The Farmer's Home Administration reported that farm loan delinquencies in Tennessee as of June 1982 averaged 27.0 percent, the same as the national average. Delinquency rates for most other Mid-South states were 7.0 to 13.0 percent higher. A boost to the farm economy came in September when a Taiwanese Procurement Mission was in Tennessee to contract for $100.0 million worth of agricultural products, primarily cotton, soybeans, and tobacco.

Mortgage lending by Tennessee's savings and loan associations totaled $23.8 million in July 1982, 43.1 percent below last July. However, net savings flow registered substantial gains from a year ago, with total deposits up 5.7 percent. Credit unions in Tennessee also managed substantial growth, with share draft accounts up 29.0 percent and savings deposits up 18.0 percent.

Commercial banking activity also experienced positive growth, with total deposits up 13.4 percent from last July and time deposits increasing 18.2 percent.

A recent Tennessee Housing Development Agency report indicated that the average cost of a new home in Tennessee for 1981 was $59,100. It also reported that the percentage gross income diverted for housing has doubled since 1969. The study concluded that "unless economic trends can be brought under control, what is currently a problem in housing will become a crisis." Some signs of improvement are apparent, however, according to the St. Louis Federal Reserve, which reported that the housing permits index for Tennessee was 8.6 points higher for the second quarter of 1982 than for the same period in 1981. On the other hand, a major blow to the Tennessee construction sector came with an announcement from the Tennessee Valley Authority that it was canceling further construction on two nuclear power plants at Hartsville and Phipps Bend, although construction is expected to continue at the Watts Bar power plant.

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unrealistic to expect that sufficient funds will [continue to] be allocated for this purpose."[6] Further, Elsasser categorized potential trainees as (1) those who would be employed without help; (2) those who need education and training in order to become employed; and (3) those who may not become employed, no matter what the training. Elsasser proposed the need for CETA programs to concentrate on the second group.

This viewpoint seems, given the anticipated limitations in resources, to correspond closely with the need for a procedure like triage in employment and training programming. In terms of policy, it appears that employment and training program operators will soon be required to introduce a selection process that eliminates certain individuals from receiving employment and training services and concentrates on individuals whose economic survival depends on treatment from the employment and training process. In rethinking training options for the unemployed, many professionals feel that the system is likely to shift from serving those "most in need" to serving those who can best profit from the expenditure of employment and training funds and resources. The result will be an altered mix of program services available to specific individuals.

Clearly, a number of individuals will become employed because they have certain attributes that will intervene in their behalf, regardless of training. Other persons may face so many labor market barriers that they cannot be assisted by employment and training programs. Training will probably not alter their situation in terms of labor market participation. They should be made tolerably comfortable through transfer payments and other available support programs. Employment and training must concentrate on the individuals whose labor market fate depends upon training. Although it is possible that a policy will be implemented that separates market-oriented work from income, or promotes "creaming" as the wisest use of tax dollars, it seems more likely that some type of triage will be adopted.

Implementation of Triage

Clearly, a triage-type procedure for manpower programs is discriminatory in nature. Moreover, any forced choice is discriminatory. In the foreseeable future, however, employment and training program operators will be required to select participants. The nagging question is: How does one objectively determine the parameter of triage? Who are the individuals who will be employed regardless of training? Who are those who can be helped by training, and who are those who cannot be helped, given the time and monetary constraints faced by employment and training programs? This is the most difficult question of all. It is apparent that a model must be developed which takes into account the myriad factors influencing labor market success or failure. This model should be objective, consistent, stable, and standardized across prime sponsors. It seems appropriate that manpower planners and those charged with policy implementation begin thinking in terms of a realistic application of triage in the local setting.

The manpower professionals charged with implementing the new employment and training policies that will result from pending legislation must be aware of the increasing need to improve the productivity of employment and training programs. Employment and training dollars in the past have been directed toward those most in need. The future effectiveness of employment and training programs rests on developing a system that identifies those who both need the training and can benefit from the training. A process using a triage approach to the classification of applicants addresses the need for increased productivity with decreased resources.

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[1] J. Edelwich and A. Brodsky, *Stages of Disillusionment in the Helping Professions* (New York: Human Sciences Press, 1980).

[2] E. W. Bakke, *The Mission of Manpower Policy* (Kalamazoo, Mich.: W. E. Upjohn Institute for Employment Research, 1969), p. 126.

[3] G. W. Sorrensen, "Current Issues in the Evolution of Manpower Policy," *Adherent* 2, no. 1 (January 1975):35.

[4] G. Schultz and K. Dam, *Economic Policy Beyond the Headlines* (New York: W. W. Norton & Co., 1977), p. 21.

[5] J. L. Mori, "May CETA Rest in Peace," *Adherent* 7, no. 2 (September 1980):59.

[6] R. Elsasser, "The New and the Old CETA: Efficiency Versus Effectiveness," *Thrust: The Journal for Employment and Training Professionals* 2, no. 1 (Winter/Spring, 1980):130.

(Continued from page 5)

[1] The Bureau of Business and Economic Research, *Memphis Housing Market Area Report* X, no. 4 (1981):6.

[2] Ibid., p. 9.

[3] David I. Siskind, "Local Area Construction Data Available from the Bureau of the Census," *Construction Review* 26, no. 5 (1980):4-8.

[4] F. W. Dodge Division, McGraw-Hill Information Systems Co., *Dodge Construction Potentials Bulletin* (New York: McGraw-Hill Book Co.).

[5] Because the equations have the lagged dependent variable as an independent variable, the permit elasticities are obtained using $n = a/(1 - b)$, where n is the permit elasticity, a is the coefficient of 1n TNPERMIT, and b is the coefficient of 1n PERMIT1.

[6] The Memphis business activity coincident index is one of the statistical series compiled and published by the Bureau of Business and Economic Research of Memphis State University for measuring general economic activities in the Memphis/Shelby County economy.

[7] Multicollinearity is an econometric problem which, when left uncorrected, will lead to imprecise estimates of the regression coefficients.

[8] See, for example, Robinson Newcomb, "Construction Forecasting," in William F. Butler and Robert A. Kavesh, eds., *How Business Economists Forecast* (New York: Prentice-Hall, Inc., 1966), p. 195.

INTERNATIONALIZING BUSINESS COMMUNICATION

*M. Gerald Lathan**

Ever since the mid-1960s when large international business firms became a very important force in the world economy as well as the individual national economy, all aspects of exporting and importing goods and services, international licensing and leasing agreements, short-term investments and borrowing in other currencies, and a wide variety of other foreign business activities have steadily increased.

Now there are over 35,000 U.S. business people who live and work overseas, over 30,000 U.S. business firms involved in exporting, and over 6,000 large companies with direct foreign investments. It is difficult to point to a firm of any size that is not involved in or affected by some aspect of international business.[1]

To educate or train people for international business, one must include all the job responsibilities that must be performed with a familiarity with the economies, politics, and cultures of various foreign countries. Overriding this knowledge is the supreme ability to communicate with the business people in regard to native business policies, based on an understanding of the similarities and differences in languages and nonverbal communication.

There is a wide variety of people who work in various capacities involving international business yet never travel abroad. Still they must fully understand the environment in which their firm's foreign operations are located in order to communicate with the company's overseas personnel or the personnel of foreign companies with which they carry on these operations.

The American Assembly of Collegiate Schools of Business (AACSB) had a strong influence on the internationalization of the curricula of business colleges when in 1974 it changed its accreditation standards so as to require the curriculum to "reflect the 'worldwide' as well as the domestic aspects of business."[2]

According to the AACSB standards, the purpose of the curriculum should be to provide for a broad education preparing the student for imaginative and responsible citizenship and leadership roles in business and society—domestic and worldwide.

There are international business programs or majors in international business for college students, but in most schools only a small percentage of students are enrolled in any of these courses. Three methods are suggested for internationalizing the business curriculum:

1. Require an international course in each department of the school of business, e.g., international accounting, international finance, etc.
2. Provide courses in each department that can be electives for students, with the requirement that each student take one international course from some department. (It may be outside their major department.)
3. Internationalize *each course* in the college of business where it is deemed appropriate.

The third method, internationalizing each business course, is the topic addressed in this article.

Some communication situations on the international scale require an understanding of cultural differences in order to accept and act upon the communication involved. Without an understanding of the Japanese language and writing system, for example, one may find Japanese business letters to be strange and unpredictable. Until about 50 years ago, Japanese letters, particularly personal letters, were written in accordance with the traditional form and style, using a roll of paper, a brush, and India ink. Although this method of writing is changing, the well-established format for writing business letters is still maintained in modern Japanese business to a large extent. The modern Japanese business letter may still begin with the salutation and follow with:

1. A remark about the season or weather
2. An inquiry about the receiver's health (in personal letters) or congratulations on the receiver's prosperity (in business letters)
3. Thanks for a gift or some other kindness recently received (in personal letters) or patronage (in business letters)

Then, the main message appears (usually the first item covered in American business letters).

Afterward, a closing remark or summary and good wishes for the receiver's health or prosperity are necessary before the complimentary close. The date, the sender's name, and the receiver's name with an appropriate title complete the format of the letter. Therefore, the letter style is characterized by politeness and formality and will seem much less vivid than English letters.

Furthermore, for domestic business, a telephone call or a personal visit is preferred to letters in Japan, because letters are not always considered the highest form of courtesy. Among the Japanese, there is much less room for misunderstanding than in international transactions.

In refusal letters, as in most "bad-news letters," American students are taught not to make a reference to

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**Assistant Professor, Office Administration Department, Memphis State University, Memphis, Tennessee.*

the "bad-news" situation by apologizing in the beginning of the letter. However, Japanese business letters that contain refusals also contain an apology at the beginning. The Japanese sales letter cannot be as vivid, personal, aggressive, high-pitched, or hard sell as the American letter because it would immediately turn the Japanese customer away. The Japanese seldom write application letters for job hunting, nor do they go directly to prospective employers.[3]

Another communication issue that has been identified as leading to difficulties in American-Japanese business tranactions involves discussions of profit and profitability. It may be that Americans and Japanese have different conceptualizations of the word *profit* and that these differences lead to what general semanticists call *bypassing*. Americans doing business with the Japanese must realize that they should define what they mean by *profit* before they negotiate—so that they meet the Japanese conception with one of their own. Clear definition of terms, even if the definitions conflict, is absolutely necessary for successful communications.[4]

Many Japanese corporations are building factories in the United States, which increases the need for American business people to understand the customs of the Japanese and their methods of communication. A recent *Newsweek* article points out that "for Tennesseeans, Japan is more than just a foreign experience . . . and the open Southern style doesn't always sit well with the traditionally reserved Japanese."[5] Many Japanese companies with U.S. operations regularly take employees back to Japan for training. The exercise is primarily aimed at convincing workers that Japanese companies are not paternalistic, sexist, uncreative, and mechanistic, which is the Western stereotype of Japanese industry.[6]

Another group of foreigners with whom Americans regularly do business is the Latin Americans. In a discussion of "the masked meanings of nonverbal messages," Jackson points out that Latin Americans and North Americans will find conversation strained if they are unfamiliar with the cultural background of each other. Latin Americans tend to stand closer during conversation, in which case North Americans would gradually inch way to protect the personal space they feel comfortable with. Because they may not understand each other's nonverbal language, the North American will be anxious to get away from the aggressive Latin, while the Latin American will view the North American's actions as cold and aloof.[7]

Although many people consider expressions to be universal, gestures and facial expressions do not have universally understood meanings. In one culture it may not be proper to reveal emotions to others, while in another emotions should be vividly expressed in strong hand movements and facial expressions. In a Latin American culture, downcast eyes do not necessarily convey a message of insubordination and insolence; instead, it is a sign of respect. On the contrary, direct eye contact shows contempt and disrespect. Managers who supervise people with a variety of cultural backgrounds will find that an understanding of these differences in backgrounds will make the task of managing much more productive and rewarding.[8]

Jerry Dillehay of the Tennessee State Department of Conservation relates his experience in writing accounts of his activities as a Peace Corps volunteer in Chile. He wrote his experiences in the report form to which he was accustomed. A Chilean secretary then took his cover letter for the report and changed it according to the format that is desired by the Chilean Ministry of Agriculture. For example, since business correspondence in Spanish-speaking countries is much more formal, letters contain elaborate titles, such as "Your Esteemed Gracious Don (Mr.) Hernado." It is considered vulgar to address anyone in a business letter as "you." In speaking and in writing friendly, personal letters, it is acceptable to use *tu* ("you"); however, in business letter writing the former is considered vulgar, and the term *usted* ("you") is preferred. Furthermore, the latter *(usted)* changes the conjugation of verbs and adjectives from those used with *tu*.

Business letters in Spanish-speaking countries are much longer, because they contain much wider margins than the American business letter. The block style is used exclusively. No abbreviations, no reference lines, and no codes are used. To do so would be an insult to the receiver. There is no letterhead, as such, for business letters. Instead, a cover sheet with the business seal printed in the center of the page is used for all business letters. The receiver of a letter writes his or her initials at the end of the letter and places an embossed seal over the initials to show receipt of the letter.

An examination of the top five foreign countries with which the United States deals reveals further illustrations of the cultural differences that the American business person should be aware of in foreign business transactions.[9] First of all, the American people are more informal than formal; they arrive on time, and keep about an arm's length between themselves when conversing. They move frequently during conversation and are relatively frank.

In Canada, French-speaking Canadians are outgoing and open but more reserved than Americans. Therefore, they may be suspicious of new ideas. Canadian gestures are similar to American gestures. Dress is more conservative and somewhat more formal than in the United States. As in the United States, however, punctuality is important in business meetings. Appropriate rules of etiquette are observed more rigidly in Canada. Promptness in showing gratitude is important. Touching is acceptable when done in a brotherly manner. Eye contact is important during conversation.

A bow is the traditional greeting in Japan. Reserve and modesty are traditionally emphasized. Compliments are graciously denied. (The Japanese feel an obligation to give an object that is complimented to the person who has given the compliment.) Correct posture is emphasized in Japanese culture. Laughter can be a sign of distress or embarrassment, as well as a sign of joy or amusement. Loyalty to one's superiors takes precedence over personal feelings. Employees are hired for life; therefore, being fired is considered a disgrace. Age and tradition are highly honored but are not allowed to impede progress. An interesting comparison between Japanese and Chinese communication is that spoken Japanese and spoken Chinese are not clearly related, but the written languages are directly related.

Mexicans usually stand close while talking, sometimes touching each other's clothing. Refusing another's offer is considered impolite. The Mexican people generally appreciate a foreigner's efforts to speak Spanish, but political and historical topics should be avoided. Because individuals are more important than schedules, the concept of time is relaxed. Most Mexicans tend to identify with their Indian rather than Spanish heritage.

In England, references to politics in public speeches should be avoided. The English appreciate short introductions of speakers. Punctuality is a plus in English business meetings. Mutually confidential, intimate, and concerned attitudes reap the best results. The English appreciate good listeners and those who are not too complimentary. Excessive gestures with the hands and gestures of intimacy are not looked upon favorably unless the intimacy is expressed toward old and dear acquaintances. Although verbal and nonverbal communication with the English is much the same as with Americans (naturally), there are some differences. Like driving on the left side of the road, the British have some words and phrases that are peculiar to their culture. Instead of saying "Hello" on the telephone, the English business person most likely would say "Are you there?" "On time" is referred to as "to time."

Germans appreciate informative speeches that contain new and intellectually stimulating ideas. References to music and literature and an indication of the speaker's appreciation and understanding of such are valued by the German people. However, they enjoy almost any topic that is well organized and developed. Conversing with the hands in the pockets is considered disrespectful. Visitors who speak German are appreciated. Visitors and correspondents should be familiar with the metric system. Schedules are listed according to the 24-hour clock (for example, 6:30 P.M. would be 18:30). German women never smile at strangers on the street.

Similarities and differences in languages are quite interesting and sometimes amusing. In Jamaica, speed bumps are called "sleeping policemen." In Mexico, the movie *Grease* is advertised as *Vaselina,* and in Colombia, it is called *Brilliantina.* However, *taxi* is spelled exactly the same in English, French, German, Swedish, Spanish, Danish, Norwegian, Dutch, and Portuguese; but eskimos have 20 different terms for the word *snow.*

Some of these cultural differences and communication customs should be emphasized throughout the business communication course, either by the instructor or by guest speakers. Many colleges have access to foreign business people who might act as guest speakers in communication classes with the specific purpose of pointing out similarities and differences in communication practices in foreign and domestic businesses. Some collegiate schools of business have on their faculty professors who have foreign cultural and/or business backgrounds. These may be used in much the same way as guest speakers from business and industry.

As a minimum, business courses should attempt to raise the awareness level of students for differences in principles and practices of international communication.

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[1] *The Internationalization of the Business School Curriculum* (St. Louis: American Assembly of Collegiate Schools of Business, 1979), pp. 1-3.

[2] *Accreditation Council Policies, Procedures, and Standards—1979-80* (St. Louis: American Assembly of Collegiate Schools of Business, 1980), p. 36.

[3] Hirosuke Shima and Saburo Haneda, "Japanese Communication Behavior as Reflected in Letter Writing," *The Journal of Business Communication* 19, no. 1 (Winter 1982):19-32.

[4] Jeremiah J. Sullivan and Naoki Kameda, "The Concept of Profit and Japanese-American Business Communication Problems," *The Journal of Business Communication* 19, no. 1 (Winter 1982):33-39.

[5] Jill Smolowe, "From Tennessee to Tokyo," *Newsweek,* Aug. 9, 1982, p. 59.

[6] Ibid.

[7] Victoria E. Jackson, "The Masked Meaning of Nonverbal Messages," *Modern Office Procedures* 27, no. 7 (July 1982):44, 46, 50.

[8] Ibid.

[9] *Culturgrams—Intercultural Communicating* (Provo, Utah: Brigham Young University Language and Intercultural Research Center, 1976 and 1979).

THE BOTTOM LINE IMPACT OF CURRENT COST DISCLOSURE

*Hartwell C. Herring and James M. Reeve**

For the past decade there has been a certain and clear trend toward increased disclosure of the impact of inflation on corporate net income. Although very little was reported about the impact of inflation in the mid-1970s, the Financial Accounting Standards Board (FASB) now requires that certain large firms show considerable supplemental current cost and price level adjusted information in footnotes to their financial statements. It is not unrealistic to expect the compliance umbrella of this FASB standard to be extended to include a larger group of reporting firms. This trend, however, has not been accompanied by grass roots support from corporation financial officers. Many remain convinced of the superior objectivity of historical cost information, and unconvinced about the presumed relevancy of current cost information in light of the cost of providing such information.

This article summarizes in common sense terms some of the complex arguments in support of this push toward disclosure of inflationary effects. Some of the background arguments are theoretical, but the capstone reason for current cost disclosure is very basic: Historical cost reporting is encouraging the misdirection of public policy in the areas of taxes, labor relations, political activities, and business regulation, and this misdirection is costing business money.

To support the contention that public policy is being misdirected because of inflated earnings numbers, the article reviews some of the theoretical issues. Listed below are five major issues related to disclosure of inflation adjusted information. The first four issues relate to the utility of the resulting financial statements. The last issue relates to the use of the information and has a direct potential impact on day-to-day business decisions.

The Issues

In support of current cost disclosure it has been proposed that:

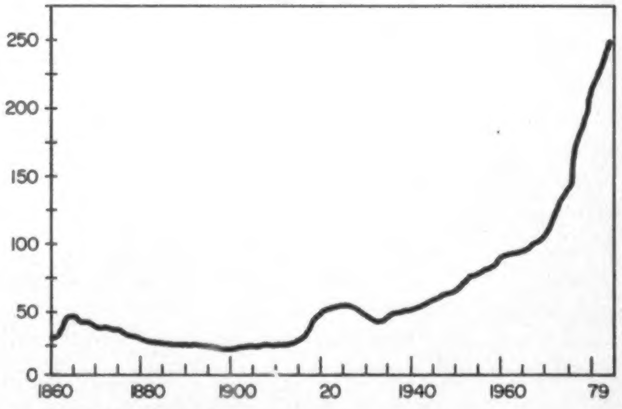
1. Historical cost income is losing relevance.
2. The real costs of doing business are more accurately measured by current cost.
3. Current cost results in a more economically valid measure of income produced.
4. Current cost produces an earnings number which more precisely indicates potential future cash flow.
5. Public policy is being misdirected because historical cost data allow the presumption that profits are excessive.

While not exhaustive, the above list captures some major issues related to disclosure of current cost data. Analyzing each in turn allows the development of substantial synthesis regarding the need for such disclosure.

Relevance of Historical Cost

Available data clearly indicate that a pattern of long-run price inflation has superseded a more stable period. Figure 1 provides information on the Consumer Price Index from 1860 to 1979. The data show that the series has a decided upward bias after 1930, indicating that economic conditions have been substantially different in the post-1930 period than they were from 1860 to 1930. In fact, except for the inflationary effects associated with the Civil War and World War 1, there are no periods of dramatic price changes in the entire 1860-1930 period.

Figure 1
CONSUMER PRICE INDEX, 1860-1979



Source: U.S. Department of Commerce.

The emergence of several new economic factors is the basic cause of this long-run inflationary bias, and at least three of these are crucial. Abandonment of the gold standard in 1932 permitted subsequent occasional periods of relatively unrestrained money supply growth. When accompanied by federal budget deficits financed by promissory notes, this money supply growth contributed substantially to the inflation problem. The other two factors worthy of mention are the adoption of product pricing policies based on costs rather than consumer demand and the willingness of trade unions to accept

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**The authors are, respectively, Associate Professor and Assistant Professor, Department of Accounting and Business Law, The University of Tennessee, Knoxville, Tennessee.*

layoffs rather than wage cuts in response to declines in the demand for labor. These latter factors have produced a pricing system for both products and labor which ratchets upward with inflationary pressure but has little if any downward movement when the business cycle enters a recessionary phase.

These conditions have persisted for so long that the historical costs of many assets no longer bear any relationship to the concepts of income measurement and financial position that are the common sense basis for accounting information systems. It is simply not relevant to know, for example, that a machine currently in use was purchased in 1967 for, say, $25,000 when the equivalent asset is now selling for three, four, or even five times that amount. This very practical reality is one of the most compelling reasons for current cost disclosure, and it is an appealing proposition regardless of theoretical support existing now or forthcoming for current cost measurements.

Measuring Real Cost

In a very real sense the costs of production are measured by the value of the resources used in production, not by the money price of these resources. Economic theory clearly demonstrates that the cost of production can be visualized as the value of alternative production sacrificed.

Placing these ideas into an accounting context simply requires that the concept of measuring the value of resources used in production be emphasized rather than the historical cost of purchasing the resources. At the date of acquisition it is reasonable to assume that the costs and values of resources of production are approximately equal. It is only with the passage of time that the two amounts are likely to diverge. Accountants have, of course, long assumed that the effect on the financial statements of this divergence could, for reasons of materiality, be ignored.

In fact, the accounting profession has concentrated on measuring dollars expended for so long that the original idea of measuring resource values has been all but forgotten. All that is required to demonstrate the superiority of current cost income statements over historical cost statements is agreement that historical cost was and has always been a stand-in for the real value of the resources used in production.

Measuring Economic Income

The problem of economic income has never been one of deciding whether such a concept is valid. The problem involves developing practical ways of measuring it. In simple terms economic income is a wealth measure — literally the change in a firm's value over time plus dividend distributions to owners. The value of the firm can best be measured by determining the discounted present value (economic value) of asset and liability cash flows. It has long been suggested that replacement cost measures may provide an adequate surrogate of economic value,[1] but no precise analytical work has been available on this issue until relatively recently.

Since 1970, two path-breaking articles have provided analyses which establish the conditions under which economic income is precisely measured by replacement cost techniques.[2] The authors of these papers have demonstrated that there is a definite tendency for the replacement cost of tangible assets to gravitate toward their use value. Stated in economic terms, the average present value of production assets will tend, because of supply and demand forces, to move toward the replacement cost of these assets in the resource or input market. In addition, these writers show that these two values will be precisely the same in perfectly competitive equilibrium.

The mapping of replacement cost values on economic values is a very desirable consequence. The result will be income numbers that represent an unambiguous measure of the true wealth change in a firm over a period of time. Such measures would not be subject to the discretionary manipulations of management, but would be a market-determined wealth measure. In addition, under replacement cost valuation, balance sheet items might well reflect a truer assessment of economic claims and obligations. Moreover, these presentations could enhance the comparability of interfirm financials. To illustrate, suppose two identical adjacent tracts of land were purchased by separate entities 10 years apart. The historical cost valuation of the land would indicate a disparity in value, while a replacement cost valuation would more accurately reflect the similarity in use value.

On a more practical plane, there are some problems with replacement value theory. As the real world becomes less and less typified by the perfectly competitive model, the market forces which work toward equating present value and replacement cost are diminished. Oligopoly is sufficiently prevalent in the American economy that one should not expect supply and demand conditions in product markets to always have substantial impact on the secondhand value of permanently installed plant assets. That is, replacement cost may bear only a casual relationship to the real value of the assets in some cases.[3]

Predicting Cash Flows

Investors have a strong need for information that goes beyond just reporting past performance, but in a sense predicts future performance. The FASB obviously embraces this position when it suggests:"Financial accounting and financial statements should provide information that helps investors and creditors assess the enterprise's prospects of obtaining net cash inflows through its earnings and financing activities."[4]

It is suspect whether the historical cost framework is robust enough to meet these expectations. Economic income, however, provides information sufficient to predict future cash flows. Even further, Revsine[5] analytically demonstrates that replacement cost income can be a lead indicator of future distributable cash flows under assumptions of perfect and complete markets.

Revsine's proposals are complex and need not be detailed here. In essence, however, he visualizes replacement cost income as having two components, a current operating component and a holding gain component. Economic income can also be dichotomized in a similar fashion — an expected component based upon the assumption that events affecting future income will transpire as available information implies, and an unexpected component which results from the economic consequences of unforeseen events such as a change in the availability of certain resources. A comparison of these concepts is illustrated in Table 1.

Table 1
COMPARISON OF ECONOMIC INCOME AND REPLACEMENT/CURRENT COST INCOME

	Economic Income	Replacement or Current Cost Income
Expected component or current operating component	Discounted present value of asset and liability cash flows assuming certainty about the future	Current cost revenue less current cost expenses
Unexpected component or holding gain/loss	Cash flows resulting from unforeseen economic events	The unrealized change in the replacement values of net assets and liabilities

The expected component of economic income can be shown to be equal to the current operating profit component of replacement cost income. Similarly, unexpected economic income corresponds to the unrealized holding elements of replacement cost income. It is this holding gain or loss that provides a lead indication of future cash flows. A change in the future cash flows expected from operating assets will be reflected in the price of those assets. Intuitively, one should expect the demand for a tangible asset, and hence the price, to increase if the expected cash flow potential for that asset increases (i.e., it has more use value). The resulting holding gain is a lead indicator of future performance with respect to the operation identified with that asset. Indeed, the aggregate holding gains or losses are an unbiased market estimate of the future cash flow potential of the firm.

Even if the assumptions of the lead indicator approach prove inappropriate, it is still possible to use the current operating profit portion of replacement cost income in predicting future levels of current operating profit. In the absence of an empirically valid time-series model of current operating profit, the best estimate of next year's current operating profit is this year's current operating profit. Although such an extrapolation does not capture causal elements, as does the lead indicator approach, it is still empirically valid.

Misdirection of Public Policy

The present set of accounting rules and conventions constitute a measurement system that may be subject to bias. To the extent external users behave as if the output of the historical cost system is producing unbiased and error-free information, a misdirection of public policy is possible. Several policy areas can be identified for which a current cost system could provide some improvement:

1. Taxation policy
2. Labor policy
3. Political policy
4. Regulatory policy

Taxation Policy

There is historical precedence indicating the importance of financial accounting rules as determinants of tax accounting rules. A well-known example is the LIFO accounting method for inventories, which was adopted by the IRS only after its introduction as a legitimate method for financial reporting. Present controversy centers around the validity of taxing earnings that are unadjusted for the effects of inflation. Indeed, there is some question whether the earnings of some entities, as reported by traditional methods, are even sufficient to maintain capital, much less evidence taxable earnings. In this regard, Table 2 provides some sobering evidence. American industries are being taxed on earnings that are inflated due to an inaccurate measuring system. Real after-tax earnings, after adjusting for replacement needs, are only one third of the after-tax income reported under the historical reporting model. The real average tax rate is fully 50 percent higher than the average tax rate implied under historical cost accounting. Therefore, it would seem in the interest of corporate and societal welfare to encourage the adoption of current value reporting so as to hasten tax code changes that will relieve American industries from the tax burden emanating from fictitious earnings.

Table 2
1980 COMPOSITE EARNINGS OF U.S. INDUSTRIAL COMPANIES
(In Billions)

	Historical Cost	Current Cost
Income from continuing operations	$172	$107
Taxes	73	73
Income from continuing operations after taxes	$99	$34
Percentage average tax rate	42	68

Source: FASB Statement 33 Data Bank.

In the absence of tax code changes to reflect a new measurement system, macro tax policy could still be modified to reflect the current cost earnings figures. A downward adjustment in the tax rate on historical earnings would accomplish the same goals as taxation on current cost earnings. Moreover, legislative proposals could be introduced to provide tax relief for those industries with large plant asset replacement needs. Proposals such as the recent depreciation rules for rail track or investment tax credit lease sales are examples of tax code changes that would benefit heavily capitalized industries and could be promoted on the basis of current cost operating performance. The result would be a corporate tax policy that more properly reflects the long-term growth needs of American industry.

Labor Policy

One element in determining the contract demands of labor is the ability to pay. This was clearly evident in the 1982 labor negotiations for the automotive, rubber, and transportation industries. It would appear that a redirected focus on the current cost earnings of American industry might temper the real demands of labor. This is not to suggest the workers of America should be tricked into contract concessions based on meaningless data. To the contrary, current cost disclosures may be more relevant than traditional disclosures. The current cost disclosures would reflect the cash flow generating capability of the firm, from which labor costs could be determined. Once the ramifications of current cost disclosures are understood, favorable dispositions may eventually be observed in the parties to the labor negotiation, including NRLB arbitrators and union negotiators.

Political Policy

During the 1979 oil crunch, news reports were describing the earnings of certain petroleum companies as "obscene," a characterization clearly designed to place these firms in the worst possible light. While the unique economic conditions of the time may have afforded these firms an opportunity for high earnings, there is no question that the use of historical cost accounting methods for inventory and plant assets contributed to their robber baron image. Table 3 separates the fact from the fiction for several American industries, including the petroleum industry. As can be seen, the so-called "obscene profits" are a product of the accounting system, not reality. Unfortunately, the public, the media, and government officials do not appear to recognize this distinction. As a result, it is not surprising to observe political pressure placed on various industries. Such pressure can take the form of either threatened or actual antitrust action, product regulation, price controls, and other punitive actions. Therefore, one would expect industry leaders, working in their best interests, to support a realignment of the measuring system with reality. In this way, the political demand of constituencies may temper with new enlightenment.

Table 3

1980 PERCENTAGE RETURN ON EQUITY BY INDUSTRY

Industry	Historical Cost	Current Cost
Chemicals	15.7	6.2
Food, Tobacco, and Textiles	16.1	7.4
Lumber, Paper, and Allied Products	13.2	3.1
Machinery	16.3	8.1
Mining and Construction	20.5	4.1
Petroleum and Rubber	15.9	2.3
Transportation and Communication	9.8	0.4
Utilities	11.1	0.7

Source: FASB Statement 33 Data Bank.

Regulatory Policy

The regulatory environment under which many natural monopolies operate also provides a reason for concern about the way operating results and financial condition are measured. This is because rate commissions focus upon historical cost rate of return targets in rate setting.[6] The last two items in Table 3 demonstrate that this focus has led to regulatory rates that are far short of any definition of "fair return." A 0.4 percent to 0.7 percent current cost rate of return would seem to be insufficient in attracting new capital and in maintaining the long-term viability of the regulated firms. An accounting system that highlights the uninflated real rate of return may pave the way for a favorable change in the rate-setting formulas.

Statement users should be entitled to believe what they read. While some users may have the capacity to visualize the inflation factor and its impact on reported data, there is little if any reason to expect that all users can or will do so. For example, a recent study involving the use of information by loan officers noted that they did not request supplemental current cost data when it was not provided and did not seem to know what to do with it when it was made available.[7] There is also no shortage of evidence which suggests that corporations believe users can be fooled by the form of information disclosure. There are literally no other reasons for such practices as applying the equity method of accounting to a 14 percent owned investee,[8] arranging of bizarre off-balance-sheet financing agreements, and undertaking innocuous debt rollover transactions which produce large paper refunding gains.[9] Accountants cannot ignore the public policy implications of corporate activities, because investors are no longer the only users of financial statements. Other members of the audience of interest include political leaders, unions, rate commissions, and a variety of special interest groups. Reporting data which reflect the most relevant economic conditions is demanded by the circumstances under which the data will be used and by the level of sophistication of many of the user groups.

Conclusion

A review of five essential issues relating to current cost disclosure reveals a growing body of logic which gives credence to its emerging status in financial reporting: (1) Historical cost reports are quite properly described as nineteenth-century economic constructs and have not adopted to revolutionary changes in several key institutions. (2) If the objective of cost measurement is to measure resources used, then logic also dictates the choice of current cost measures for expenses in the income statement. (3) Current cost reports produce a more valid measure of income because the nature of economic forces tends to equate the value of resources with their current prices in markets. (4) An examination of the evidence on the nature of economic income reveals that current cost income may provide substantial information about expected future cash flows. (5) An increase in the number

(Continued on page 26)

THE BETAMAX VIDEO CASSETTE RECORDER DECISION

Copyright Infringement?

*Paul Lansing and Eugene R. Schwarting**

On October 19, 1981, the U.S. Court of Appeals for the Ninth Circuit overturned an earlier decision made by the U.S. District Court, Central District of California, and ruled that the video recording of copyrighted material by private individuals constituted copyright infringement.

This case represents more than a copyright dispute between two business enterprises. It impacts the producers of motion pictures and television programs and those engaged in these productions; the manufacturers of video recorders and video accessories; the retailers of video recorders and associated tapes and devices; their advertising agencies; and individuals who buy and use these devices in the privacy of their homes. It is an example of situations which will likely arise more frequently in the future—in which technological advances bring about legal conflicts involving business and society.

Background

The Sony Corporation of America began marketing the Betamax video cassette tape recorder (VCR) in the United States in 1975. Suit was brought against Sony in November 1976 by Universal City Studios, Inc., and Walt Disney Productions. In addition to Sony Corporation (the manufacturer) and Sony Corporation of America (the American distributor), four retail establishments that sold the Betamax, the advertising agency retained by Sony, and an individual owner and user of the Betamax were included in the suit. The plaintiffs, as producers and owners of copyrighted television films, charged that purchasers of VCRs infringe on the film owners' copyrights when they use their VCRs to record copyrighted films which are broadcast on television. The plaintiffs contended that Sony contributed to this violation of the Federal Copyright Act of 1976 because the Betamax VCR is sold "for the primary purpose of reproducing television programming." The U.S. District Court, Central District of California, decided in 1979, after three years of litigation and a five-week nonjury trial, that in-home video taping was a "fair use" of copyrighted material and did not constitute infringement. The district court further held that manufacturers of VCRs could not be held liable for contributory infringement.[1]

This decision was appealed to the U.S. Court of Appeals, Ninth Circuit, on February 6, 1981. In the decision of October 19, 1981, the Ninth Circuit Court largely reversed and returned the decision to the district court in a unanimous three-judge opinion. The Ninth Circuit Court's opinion stated that the district court should have applied the "unambiguous" language of the 1976 Copyright Act, which strictly defines the exemptions to the copyright law:

> The statutory framework of the 1976 Copyright Act is unambiguous; the grant of exclusive rights is only limited by the statutory exemptions. . . . We should not, absent a clear direction from Congress, disrupt this framework by carving out exemptions to the broad grant of rights apart from those in the statute itself.[2]

Further, although the district court was heavily influenced by the fact that in-home recording of *sound* recordings has not been halted by the copyright laws, the Ninth Circuit Court emphasized that *audiovisual* works are in a different class and that Congress has traditionally shown "special solicitude for audiovisual works." Consequently the Ninth Circuit Court found that "off-the-air copying of copyrighted audiovisual materials by owners of videotape recorders in their own home for private noncommercial use constitutes an infringement of applicant's copyrighted audiovisual material."[3]

Since virtually all material broadcast on TV is copyrighted, VCRs are not suitable for substantial noninfringing use. Consequently, the court ruled that VCRs cannot be considered "staple articles of commerce," and the defendants cannot escape well-established principles of contributory infringement.

In suggesting the form of relief to the lower court, the Ninth Circuit Court recognized that an injunction could cause great damage to the public. It therefore suggested an award of damages or a continuing royalty as an acceptable resolution of the conflict. Sony and the other plaintiffs have recently asked the U.S. Supreme Court to review the decision handed down by the Ninth Circuit Court.[4]

The decision could have a significant impact on the businesses engaged in the manufacture and sale of VCRs, as well as purchasers and users of the equipment. Annual sales of VCRs have grown from 100,000 units in 1977 to over 1.6 million units in 1981—a growth rate of over 100 percent annually.[5] In addition to Sony, several other manufacturers sell VCRs, including Matsushita, which produces VHS-format models. The VCRs manufactured

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**The authors are, respectively, Associate Professor, Department of Industrial Relations and Human Resources, University of Iowa, Iowa City, Iowa, and Programs Manager, Collins General Aviation Division, Rockwell International, Cedar Rapids, Iowa.*

by Sony are also brand-labeled by Zenith, Sanyo, Toshiba, and Sears; the recorders manufactured by Matsushita are sold by affiliates Panasonic, Quasar, and JVC, as well as by General Electric, and by North American Philips Consumer Electronic Corporation under Magnavox, Philco, and Sylvania labels.[6] VCRs represent over 25 percent of Sony's sales worldwide. The VCRs manufactured and sold in the United States represent a 3 billion dollar industry, including hardware and software (blank recording tape and prerecorded tapes.) Over 5,000 video and video software dealers in the United States are potentially affected by the decision. Also affected are the users of the over 3.2 billion VCRs that have been sold in the United States—estimated at 12 million consumers.[7]

The Issues and Arguments

The central issue in this dispute is: Does off-the-air copying of copyrighted audiovisual materials by owners of video tape recorders in their homes for private noncommercial use constitute an infringement of the Copyright Act of 1976? A secondary issue arises if such recording is found to represent infringement: Can the manufacturers and retailers of video recorders be held liable as contributory infringers?

No Copyright Infringement

Those who argue that copyrights are not infringed upon by in-home noncommercial recording of video programming present a number of persuasive arguments. Probably the most powerful argument posed is that restriction of use of video recorders constitutes an invasion of the privacy of users. Any "policing" of the activity would constitute an infringement of the rights of citizens to do as they please in their own homes. As Tee Yakura, merchandising manager of video tape recorders for Hitachi Sales Corporation, said: "I don't see how they can enforce this. You are talking about an invasion of the privacy of the home."[8] Jack Wayman, senior vice president of the Electronic Industries Association, a consumer electronics group, supports this argument: "It is our belief that the decision violates the public interest by prohibiting the American consumers from utilizing and enjoying a product which significantly improves the quality of their lives."[9]

The supporters of this position point out that the motion picture producers have already been satisfactorily compensated by the television broadcasters for the rights to run their copyright movies on television, and that a secondary compensation in the form of a royalty paid by consumers is unwarranted. They suggest that the movie producers have another revenue source they are attempting to protect—that from selling and renting prerecorded video tapes of major motion pictures—and that this revenue source would potentially yield them more income than that from showing movies on television.[10]

It is suggested that VCRs actually pose little threat to the movie producers. They may even create an opportunity for the producers, in that the sale of prerecorded tapes of old movies would have little market value in theaters or on television. Jack Wayman notes that "the motion picture industry is making a tremendous amount of money off these tapes that were really dog movies."[11]

The thought that subsequent reshowing of programs recorded in the home will harm the sale of prerecorded tapes is refuted by John Fleming, professor of law, University of California at Berkeley: "The studies show that archiving—the taping of shows for storage and repeated use—is relatively rare. Most owners seem to use them to tape a show that was on when they were out and then erase it after they have seen it. In that situation, the show's owners may actually be benefiting. As a result, the show's audience is bigger."[12]

Supporters of in-home video recording recognize the rights of holders of copyrighted material, and agree that piracy of such material is illegal. However, they point out that audio-only recording of copyrighted material from radio and television programming has been permitted. Congress, when it granted limited copyright protection to sound recordings in 1971, made it clear in the legislative history that "it is not the intent . . . to restrain the home recording, from broadcasts or from tapes or records, of recorded performances, where the home recording is for private use and with no purpose of reproducing or otherwise capitalizing commercially on it."[13] The supporters of in-home video recording feel that this congressional intent applies to video recording as well as audio-only recording.

As support of their position, the proponents note that over 30 countries have already enacted personal-use exemptions for video recording in the home. Most European countries, whose copyright laws are similar in many respects to those of the United States, exempt single audio and video copies of copyrighted works made for personal use. Only three countries—Norway, Austria, and West Germany—require royalties be paid to copyright holders. Furthermore, it is noted that the distribution of the royalties collected in West Germany, where the system has been in effect for 16 years, has broken down. Disputes over the methodology of the allocation system have prevented the distribution of royalties since 1977.[14]

Thus, it is argued that not only would it be nearly impossible to fairly determine who was recording, but even if such a scheme could be devised, the distribution of the royalties would be unworkable.

Finally, the proponents of in-home video recording suggest a financial hardship will be imposed on the manufacturers and sellers of video recording products if the ruling of the Court of Appeals is upheld. Either through increased pricing or through fear of legal repercussions, potential buyers will be discouraged from purchasing video cassette recorders altogether, or they will be forced toward videodisc players (which cannot record),thus causing financial harm to video cassette recorders and recording tapes. Sony and the Betamax retailers, in their request to the Supreme Court to review the decision of the Ninth Court of Appeals, state that any delay "will threaten the home recording practices of millions, and will leave open to imminent destruction the livelihoods of millions of those involved in the home VCR business."[15]

Copyright Infringement

Those who argue that in-home video recording does infringe on copyrights base their arguments on the strict interpretation of the Copyright Act of 1976. Article I, Section 8, clause 8 of the United States Constitution empowers the Congress: "To promote the progress of science and useful arts, by securing, for limited times, to authors and inventors, the exclusive right to their respective writings and discoveries." The intent of this clause is to encourage works of intellect, and to do so by reliance on the economic incentives granted to authors and inventors. The Copyright Act of 1976 provides that the owner of a copyright has the exclusive right to reproduce the copyrighted work in copies or phonorecords, or, in the case of motion pictures, to display the copyrighted work publicly.[16] Thus, the Ninth Circuit Court of Appeals concluded that "the statutory framework is unambiguous: the grant of exclusive rights is only limited by the statutory exceptions."[17]

Supporters of this position contend that, although not specifically addressed in the law, sound recordings should be treated differently from audiovisual recordings. The two types of recording are treated as separate categories of protected materials in the Copyright Act.[18] Even though sound recordings in the home are excepted in the Copyright Act, Congress did not intend to create a blanket exemption for all forms of home recording[19]—especially since the issue of video recording had not yet been brought up when the 1976 Copyright Act was drafted. Furthermore, the Court contends that Congress has traditionally shown "special solicitude" for audiovisual works, in recognition of the increased level of investment associated with their creation. Thus, according to the Ninth Court of Appeals decision, the precedent established in allowing in-home sound recordings off the air does not apply to audiovisual recordings.

In their November 1976 suit, Universal Studios and Disney argued that in-home recording would seriously affect the future earnings potential of copyright owners. They assumed that VCRs would severely reduce the profits of those producing shows for movie theaters and television. This would occur in two ways: (1) consumers would wait until a movie was on TV, then tape it, thus skipping the initial visit to the theater *and* repeat visits, and (2) the prices charged for TV programs sold for reruns would be reduced because many people in the potential audience would already have the programs in their own tape libraries.[20]

The Ninth Court of Appeals supported this viewpoint with an analysis of the "fair use" doctrine:

> New technology, which makes possible the mass reproduction of copyrighted material (effectively taking control of access from the author), places a strain upon the fair use doctrine. A court, if it decides that fair use is applicable, is required to weigh—in "balancing the equities"—the "benefit" of an extremely popular increase in access with "harm" to a plaintiff. . . . It is our conviction that the fair use doctrine does not sanction home video-recording. Without a "productive use," i.e., when copyrighted material is reproduced for its intrinsic use, the mass copying of the sort involved in this case precludes an application of fair use.[21]

This conclusion is based on the definition of "fair use" provided by Congress in the 1976 Copyright Act, which reads: "the fair use of a copyrighted work, including such use by reproduction in copies or phonorecords . . . for purposes such as criticism, comment, news reporting, teaching, . . . scholarship, or research, is not an infringement of copyright."[22] This definition does not list "convenience" or "entertainment" or "increased access" as purposes within the scope of fair use. Thus, according to the Ninth Circuit Court of Appeals, copyright owners would be deprived of the opportunity to exploit the market potential for their works if home users of video recorders were permitted to freely copy them.

The supporters of the infringement argument further contend that the manufacturers of the video recording equipment are liable. The Ninth Circuit Court of Appeals supported this contention:

> Videotape recorders are manufactured, advertised, and sold for the primary purpose of reproducing television programming. Virtually all television programming is copyrighted material [footnote omitted]. Therefore, videotape recorders are not "suitable for substantial noninfringing uses." . . . The corporate appellees [Sony and retail stores] "know" that the Betamax will be used to reproduce copyrighted materials. . . . There is no doubt that appellees have met the other requirements for contributory infringement—inducing, causing, or materially contributing to the infringing conduct of another. The corporate appellees are sufficiently engaged in the enterprise to be held accountable.[23]

Finally, the supporters of the infringement argument contend that foreign manufacturers of video recording equipment are getting a free ride on the backs of the American creative community. They further argue that continued infringement will destroy the incentive to create quality entertainment and deprive the creative talent of the compensation for their work.[24]

Alternatives

The ultimate outcome of this dispute will have potentially far-reaching effects on the copyright laws in the future. According to David Ladd, Register of Copyrights, the central problem is one of deciding how to allow public access to copyrighted material while assuring compensation to program producers, authors, and other creative talent: "The video question, and the broader problem it represents of accommodating the property rights of copyright to new technologies, are too difficult, too pervasive, too important, too profound to be resolved in posse-like speed."[25]

In addition to the judicial action instituted by Sony to the Supreme Court for review of the Ninth Circuit Court's decision, legislative action has been initiated in both the House and Senate to permit unlimited video recording for private use[26] and to require the licensing for video recorders and the payment of royalties to copyright owners.[27]

It is difficult to imagine that irreparable harm would be done to the creative motion picture and television industries by exempting in-home video recording from the copyright law. As Lewis Wasserman, chairman of the board of MCA (parent company of Universal City Studios), stated, "People that have constantly forecast the doom of a particular industry in the entertainment industry (such as the doom of radio stations when TV began to develop) have historically been wrong."[28]

On the other hand, the imposition of a royalty scheme on video recording equipment and tapes, to compensate copyright owners, would appear to impose only modest disincentive to the purchase of such equipment. Leslie Latham, consumer information manager for corporate communications, Sony Corporation of America, estimated the royalty on a video recorder at $50, and on a video tape at $1 to $2—roughly 5 to 10 percent of the retail price.[29] Indeed, a mechanism already exists to administer the distribution of royalties so collected—the Copyright Royalty Tribunal, created under the Copyright Act, would determine, collect, and distribute the fees.[30] Although such a solution might not be workable, it would preserve the intent of the copyright law to protect creative works.

From a personal viewpoint, the authors would prefer to see the copyright law revised to exclude the use of in-home video recording from copyright infringement liability. The authors believe that the motion picture producers are demonstrating unwarranted concern (possibly even greed), and that they actually have more to gain by broadening their viewer audience than they would by restricting it.

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[1] *Universal City Studios, Inc., v. Sony Corp. of America*, 480 F. Supp. 429 (C.D. Cal. 1979).

[2] *Universal City Studios, Inc., v. Sony Corp. of America*, 659 F. 2d 936, 211 USPQ 761 (CA9 1981).

[3] Ibid.

[4] "Sony Corp. Seeks Reversal of Betamax Decision," *HFD—Retailing Home Furnishings*, Mar. 22, 1982, sec. 1, p. 33.

[5] Mark Halper, "VCR Firms React to Copyright Case," *Electronic News*, Oct. 26, 1981, p. 16.

[6] Ibid.

[7] Leslie Latham, Sony Corp., radio interview on "Project 600," Radio Station WMT, Cedar Rapids, Iowa, Apr. 5, 1982.

[8] John Andrew and Laura Landra, "Home Video Gear Breaks Copyright Law in Taping Over-the-Air TV, Court Rules," *Wall Street Journal*, Oct. 21, 1981, p. 3.

[9] Barnaby J. Feder, "Private Videotaping of Copyrighted TV Ruled Infringement," *New York Times*, Oct. 21, 1981, pp. Al, D6.

[10] Latham.

[11] Andrew Pollack, "Video Recorder Sales Go On," *New York Times*, Oct. 21, 1981, p. Al.

[12] Feder, p. D6

[13] *U.S. Code. Cong. & Admin. News*, 1971, 1566 at 1572, cited in *Universal v. Sony* (CA9 1981).

[14] Suzanne Barnes, "Video Owners Urged to Protect Their Rights," *Cedar Rapids Gazette*, Apr. 6, 1982, p. 3A.

[15] "Sony Corp. Seeks Reversal," p. 33.

[16] 17 U.S.C., sec. 106, Copyright Act of 1976.

[17] *Universal v. Sony* (CA9 1981).

[18] 17 U.S.C., sec. 102(a)(6) lists "motion pictures and other audiovisual works" as being copyrightable; sec. 102(a)(7) lists "sound recordings." Audiovisual materials are specifically excluded from some exemptions by the 1976 Act: 17 U.S.C., sec. 108(h), 110(1), 112(a).

[19] 17 U.S.C., sec. 108(f)(3), in which libraries may make video recordings of newscasts but may only distribute such material by lending.

[20] Feder.

[21] *Universal v. Sony* (CA9 1981), sec. II.

[22] 17 U.S.C., sec. 107.

[23] *Universal v. Sony* (CA9 1981), sec. II.

[24] Sid Sheenberg, President of MCA, Inc. (the parent company of Universal City Studios), "Senate Committee Holds Hearing on Bill to Nullify 'Betamax' Ruling," *BNA's Patent, Trademark & Copyright Journal*, no. 557, Dec. 3, 1981, p. A-l.

[25] "Register of Copyrights Warns Against Overreacting to 'Betamax' Decision," *BNA's Patent, Trademark & Copyright Journal*, no. 554, Nov. 12, 1981, p. A-2.

[26] S. 1758 and H.R. 4808 would amend 17 U.S.C., the 1976 Copyright Act. *BNA's Patent, Trademark & Copyright Journal*, no. 552, Oct. 29, 1981, p. A-1.

[27] Amendment 1242, S. 1758, "Compulsory License Is Proposed for Sale of Home Videorecorders, " *BNA's Patent, Trademark & Copyright Journal*, no. 567, Feb. 18, 1982, pp. A-6 through A-11; and H.R. 5488, "House Bill Would Create Compulsory License for Sale of Video Cassette Recorders and Blank Tapes," *BNA's Patent, Trademark & Copyright Journal*, no. 568, Feb. 25, 1982, pp. A-6 and A-7.

[28] Ron Schneiderman, "Sony Wins MCA/Disney Suit on Off-Air Home Taping," *Merchandising*, November 1979, p. 52.

[29] Latham.

[30] "Compulsory License," *BNA's Patent, Trademark & Copyright Journal*, Feb. 18, 1982.

(Continued from page 22)

of unsophisticated statement users is resulting in misdirection of public policy because of the users' failure to understand how historical cost financial statements tend to overstate net income during inflationary periods.

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[1] Among the many proponents of this view are Kenneth MacNeal, *Truth in Accounting* (Houston: Scholars Book Co., 1970), pp. 156-7; and American Accounting Association, Committee on Concepts and Standards: Long Lived Assets, "Accounting for Land, Buildings and Equipment," *The Accounting Review*, July 1964, p. 694.

[2] Lawrence Revsine, "On the Correspondence between Replacement Cost Income and Economic Income," *The Accounting Review*, July 1970, pp. 513-23; and John S. Cook and Oscar J. Holzmann, "Current Cost and Present Value in Income Theory," *The Accounting Review*, October 1976, pp. 778-87.

[3] Fred A. Jacobs, Hartwell C. Herring III, and James W. Park, "Some Extensions of the Microeconomic Implications for Replacement Costing," *Proceedings of the Thirty-third Annual American Accounting Association Southeast Regional Group Meeting*, Birmingham, April 30-May 2, 1981, pp. 117-21.

[4] FASB, *Tentative Conclusions on Objectives of Financial Statements of Business Enterprises*, December 1976, p. 4.

[5] Lawrence Revsine, *Replacement Cost Accounting* (Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1973).

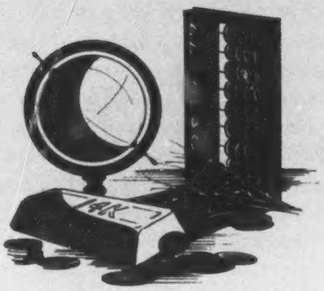
[6] See Robert M. Bowen, "Valuation of Earnings Components in the Electric Utility Industry," *The Accounting Review*, January 1981, pp. 1-22, for a discussion on the rate-setting policies of public commissions.

[7] Jane E. Campbell, "An Empirical Investigation of the Impact on the Decision Process of Loan Officers of Separate Accounting Standards for Smaller and/or Closely Held Companies" (unpublished D.B.A. dissertation, The University of Tennessee, 1981), pp. 104-6.

[8] Re: Curtiss-Wright interest in Kennecott, a firm six times its size, in 1979. See *Wall Street Journal*, Jan 21, 1981, p. 23.

[9] Re: United Brands Case in 1974. See Lawrence Minard and David A. Wilson, *Forbes Numbers Game* (Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1980), pp. 110-13.

TAX CORNER



by Wm. Brent Carper, Ph.D, C.P.A.

TEFRA IMPOSES NEW ALTERNATIVE MINIMUM TAX ON INDIVIDUALS

On September 3, with the stroke of his pen, President Reagan signed into law the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). This controversial revenue raising and revenue spending Act is intended to reduce government spending by approximately $32 billion and to correspondingly increase revenues by about $98.3 billion over the next three years.

The Act, as originally reported by the House Committee on Ways and Means in December 1981, included only six income tax and excise tax provisions. These provisions dealt with the award of attorneys' fees in civil tax litigation, modifications of personal holding company tests, repeal of certain excise taxes, rental of family residences, net operating loss carryovers, and modifications of accrual of taxes. Interestingly enough, none of these provisions were included in the Senate amendments and only one provision was made part of the final Act. Basically, the Senate Committee on Finance, under the leadership of Senator Robert Dole, totally rewrote the Act, eliminating the six originally proposed House Committee provisions and replacing the initial proposals with 107 new provisions.

Article 1, Section 7, of the Constitution provides that all bills raising revenue shall originate in the House of Representatives. A group of Congressmen led by Representative W. Hensen Moore accordingly challenged the bill, contending that the Senate Committee on Finance had totally ignored the House version of the Act and literally initiated their own tax bill. The challenge proved unsuccessful. Thus, TEFRA is now law.

Alternative Minimum Tax (AMT)

The new law repeals the minimum tax for noncorporate taxpayers. Congress has replaced it with a more comprehensive alternative minimum tax that increases the likelihood of a taxpayer incurring the AMT. It has been estimated conservatively that as many as 300,000 taxpayers may be affected by the change.

Prior Law

Individuals paid an add-on minimum tax on certain tax preferences and an alternative minimum tax which was payable to the extent that it exceeded the individual's regular tax liability (including the add-on minimum tax). The add-on minimum tax thus was in addition to the individual's regular tax. The amount of the add-on minimum tax was 15 percent of the sum of tax preference items in excess of the greater of one-half of the regular income tax paid or $10,000.

Tax preference items included in the add-on minimum tax base were:

1. The excess of the fair market value of the stock over the option price at the time of exercise on restricted employee stock options
2. The excess of accelerated depreciation over allowable straight-line depreciation for real property (15 years in the case of property eligible for accelerated cost recovery)
3. The excess of accelerated depreciation over straight-line depreciation on personal property subject to a lease
4. The excess of rapid amortization of pollution control facilities and child care facilities over the recovery allowance of regular depreciation
5. The excess of allowable percentage depletion over the adjusted basis of the property at the end of the taxable year
6. The amount by which the excess intangible drilling cost arising in the tax year with respect to cost is greater than the taxpayer's net income from oil, gas, and geothermal properties for the year

Individuals also were subject to an alternative minimum tax to the extent that it exceeded the sum of the regular and add-on minimum taxes. The tax was imposed on taxable income increased by the long-term capital gains (LTCG) deduction (60 percent of LTCG) and adjusted itemized deductions (other than those for medical expenses, casualty losses, and state, local, and foreign taxes) in excess of 60 percent of adjusted gross income reduced by the itemized deductions excluded above.

The AMT was 10 percent on the alternative minimum taxable income from $20,000 to $60,000 and 20 percent on the amount over $60,000. The foreign tax credit was allowed in full to offset dollar for dollar the AMT liability. Other tax credits generally were allowed to offset the tax only if attributable to an active trade or business and only to the extent the tax was not attributable to net capital gains or adjusted itemized deductions.

New Law

Beginning in 1983, TEFRA repeals the add-on minimum tax and expands the alternative minimum tax to ensure that everyone who might otherwise avoid taxes because of certain deductible tax preferences pays a 20 percent tax on alternative minimum taxable income. For affected individuals, the alternative minimum taxable income can include up to 11 different tax preference items, which are added to adjusted gross income, minus specified deductions, to arrive at an alternative minimum tax base.

TEFRA establishes a flat tax of 20 percent on the amount by which the alternative minimum taxable income exceeds $30,000 ($40,000 on a joint return, and $20,000 for married couples filing separately and for estates and trusts). The taxpayer then pays the *greater* amount, e.g., the regular tax or the alternative minimum tax reduced only by a limited foreign tax credit if applicable.

The 11 tax preferences which are added to adjusted gross income (AGI) minus specified itemized deductions include the following:

1. The previously mentioned six tax preferences under the old add-on minimum tax
2. The 60 percent deduction for long-term capital gains (a tax preference in computing the old AMT)
3. The dividend income excluded under the $100/$200 exclusion (new tax preference)
4. The interest excluded under the "all savers certificates" exclusion (new tax preference)
5. The interest excluded under the 15 percent net interest exclusion scheduled to become effective in 1984 (new tax preference)
6. The excess of expensing over 10-year amortization, for mining exploration and development costs, research and development costs, and magazine and publication expenses. Individuals will not have a tax preference item to the extent that they elect to amortize such costs over 10 years as opposed to expensing more rapidly.

The specified itemized deductions that are subtracted from adjusted gross income prior to adding back the tax preferences include the following items:

1. Charitable contributions
2. Medical expenses in excess of 10 percent of AGI
3. Casualty losses in excess of 10 percent of AGI
4. Personal housing interest
5. Estate taxes
6. Certain interest to the extent of net investment income
7. Wagering losses allowable under Code Section 165

Adjusted gross income also may be reduced by the alternative tax net operating loss, as well as any income included under Code Section 667, which deals with excess distributions by complex trusts. Any net operating losses will be reduced by items of tax preferences.

Once the calculation of alternative minimum taxable income is complete, the resulting sum *in excess* of $30,000 for a single taxpayer, $40,000 for a married taxpayer filing jointly, and $20,000 for a married taxpayer filing separately is multiplied by a flat tax rate of 20 percent to determine the alternative minimum tax. The taxpayer then pays the *greater* of the two taxes, either the regular tax or the AMT.

Some Planning Considerations

Corporate executives exercising incentive stock options (introduced by the 1981 Economic Recovery Tax Act) will need to consider the AMT implications where a significant spread exists between the market value and the option price at date of exercise. Tax-oriented investments involving research and development costs and magazine circulation costs should be reviewed. Those items are now tax preferences under the new law. Now that interest on "all savers certificates" is a tax preference item, tax-free state and municipal bonds may produce a higher after-tax return than the "all savers certificates" with an equivalent stated yield. These are just a few considerations.

Conclusion

There is a saying in the theory and practice of tax law that "Congress giveth and Congress taketh away." This year, as clearly evidenced by the new alternative minimum tax, Congress taketh away. As always, the reader is encouraged to seek the advice and counsel of his/her tax advisor should a more detailed explanation be required.

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December 9, 1982

The Peabody Memphis Ballroom

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11:45 - 12:15 p.m.	LUNCHEON
12:15 - 12:25 p.m.	WELCOME *Thomas Carpenter, President, Memphis State University* *M. E. Bond, Dean, The Fogelman College of Business & Economics, Memphis State University*
12:25 - 12:45 p.m.	OPENING REMARKS *Lewis R. Donelson, Attorney and former Commissioner of Department of Finance & Administration, State of Tennessee*
12:45 - 1:05 p.m.	NATIONAL ECONOMY - 1983 *Donald Ratajczak, Director, Economic Forecasting Project, Georgia State University, Atlanta, Georgia*
1:05 - 1:20 p.m.	FINANCIAL MARKETS - 1983 *Robert J. Genetski, Vice President and Chief Economist, Harris Trust & Savings Bank, Chicago, Illinois*
1:20 - 1:35 p.m.	MID-SOUTH ECONOMY - 1983 *Dale G. Bails, Associate Professor of Economics, Department of Economics, Memphis State University*
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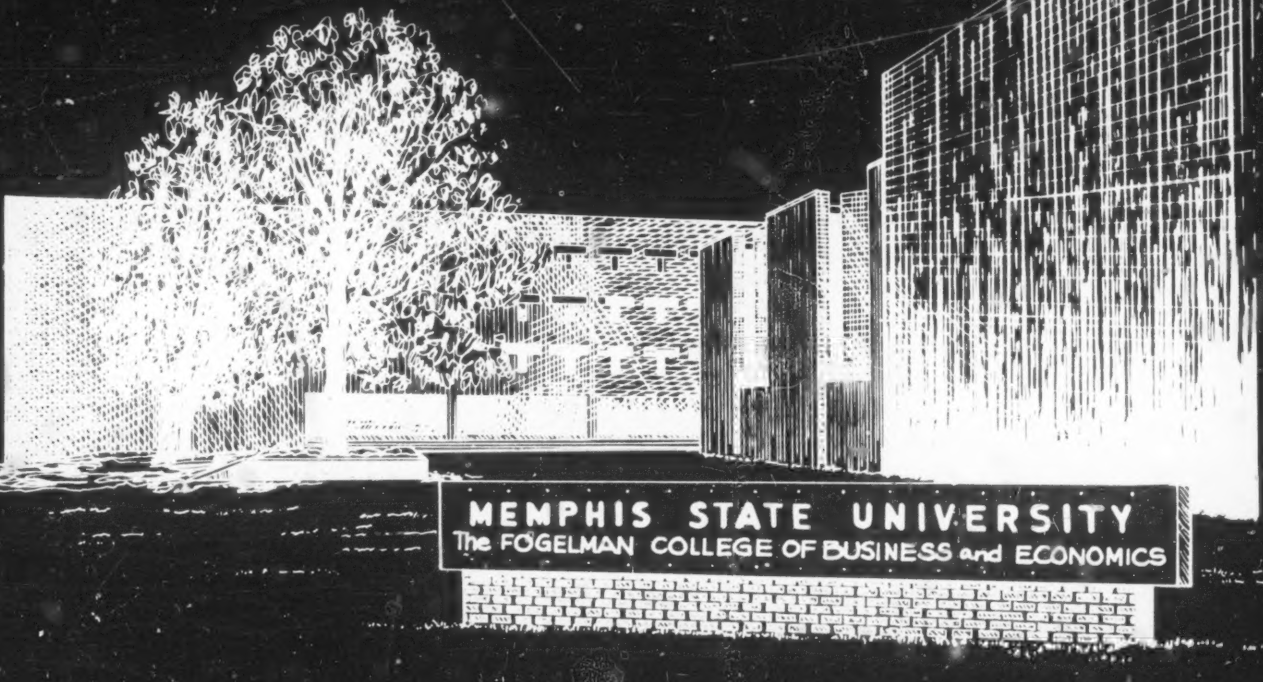
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OF BUSINESS AND ECONOMICS

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PLANNING PRODUCT PORTFOLIO STRATEGIES

*Rodger D. Carlson**

Recently, there has been considerable emphasis on the development of product portfolio strategies. One approach that has received a lot of attention is the approach attributed to the Boston Consulting Group (BCG).

This article develops a new approach in three dimensions that extends the basic concept of the Boston Consulting Group. However, before elaborating on the details of the new model, a summary will be presented to give the necessary background of the Boston Consulting Group.

The Boston Consulting Group Approach

The BCG developed a four-box matrix for the analysis of a product portfolio. This matrix takes into account only two pieces of information: market growth rate and market share dominance. This product portfolio provides the information needed to get a mixture of products that generate cash and of products in which the company can invest cash.[1] It is naturally important to balance the product mix so that some products are producing cash while other products are using cash.

When developing a product portfolio, the company first should identify its product market. The company must realize that this is a complicated and difficult task. Defining the product market is important when computing market share dominance and market growth rate.

Bruce Henderson, president of BCG, believes that "each market segment can support only three competitors profitably."[2] BCG advises businesses to participate in those markets where their product has a chance of becoming number one or two in the market. The reason for this is that market share correlates with product profitability.

All the competitors are assumed to have the same overhead structures and experience curves, with their position on the experience curve corresponding to their market share position. Hence, market share dominance is a proxy for the relative profit performance.[3]

The BCG uses market share dominance as computed by dividing the company share by the share of the largest competitor. This is done because if a company has a 5.0 percent market share, this is relatively high if the leading competitor has a 7.0 percent market share. However, if the leading competitor has a 40.0 percent market share, then the 5.0 percent market share is relatively low.

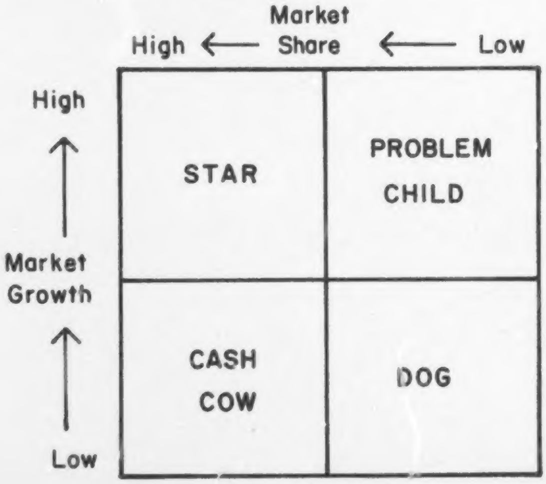
The Product Life Cycle (PLC) is also important when developing strategic plans for products. It is important to establish the end of the growth and maturity stages of the PLC. The PLC influences the market growth rate. The market growth rate is measured through sales. Growth rate is influenced by the definition the company sets for the product market. A broad product market will have a longer maturity stage than a specific product market.[4]

External factors can influence the growth rate. Thus, the PLC may not be in the maturity stage although sales are leveling off. If the Gross National Product is level, high growth rates are harder to achieve for all products, whether they are in the growth or maturity stage of the life cycle. Sales can be influenced by price changes, economic fluctuations, and population changes. Market growth will also decline as competitors enter the market. Competition increases in the market growth stage and becomes more aggressive in the maturity stage.[5]

All products have different life-cycle patterns. The length of the various stages will vary from product to product. Some products will have longer life spans than others, so their growth rate will increase over a longer period.

The BCG classifies products by using a four-box matrix (see Figure 1). The four-box matrix consists of "cash cows," "stars," "dogs," and "problem children." Cash cows are products with a low growth rate and dominant market share. They are profitable products that generate more cash than is required for maintaining market share. Strategies should definitely be aimed at maintaining market share dominance.

Figure 1
BCG PRODUCT CLASSIFICATION MATRIX



Associate Professor, Department of Marketing, School of Business, University of South Dakota, Vermillion, South Dakota.

Stars are products that have a high growth rate and a dominant market share. They produce much profit but also require a lot of cash to finance the rate of growth. Strategies for these products should be aimed at acquiring new users or new ways of using the products that will be a source of market growth. Strategies also should be designed to maintain existing share of the market through price reductions, product improvement, better market coverage, and increases in production efficiency. Management should be careful not to maximize short-run profits at the expense of long-run market share.

Dogs are products that have a low growth rate and low market share dominance. Most of the products fall into this category. There are few opportunities for a dog to grow at a reasonable cost. To gain market share from the dominant competitor is costly and time-consuming, since the competitor will resist. The reason a dog is kept is because it does show some profit.

Problem children, or question marks, are products with a high growth rate and a low market share dominance. Problem children create an enormous demand for cash. If they do not get this cash, they become dogs. Strategy should steer toward heavy investments to obtain a disproportionate share of new sales or market shares of the competitors, thus creating a product in the star category.

A Three-Dimensional Model

Ralston Purina Company is the company that was selected to illustrate the new three-dimensional model for planning product portfolios. Ralston Purina is the world's largest producer of pet foods and commercial feeds for livestock and poultry.

The firm has gradually diversified and now has divisions that fall into four primary categories:

Grocery products
Agriculture products
Restaurants
Diversified businesses

In recent years, Ralston Purina has also expanded into the international market.

To develop a three-dimensional model, one must find another viable dimension. Some of the variables to be considered have to do with sales, profit, business strengths, industry or market attractiveness, saturation levels, and return on investment. Since only one variable will eventually be chosen, some sort of elimination process must be applied. The model to which the variable is to be applied is a starting point for the elimination process.

The first step in this study was to apply some definitions to the variables which were under consideration:

1. Both market growth and market share have to do with sales in the industry. Thus, sales was eliminated because it already is well-represented.
2. Business strengths are usually thought of in two parts: (a) market position and (b) competitive strength (defined in terms of quality, technology, marketing, and profitability). Since market position is already represented, it too was eliminated. However, competitive strength may be considered further.
3. Industry or market attractiveness can include market size, market growth, profitability, and cyclicality. Again, the two original dimensions are represented.
4. Saturation levels can be shown by market share and market growth, so this variable was eliminated at this point.
5. Return on investment was considered because financially it indicates how the company is doing.
6. Profit includes such items as price trends, profitability, and gross margin trends.

In reviewing these definitions, one common item kept recurring—namely, corporate profitability. Since corporate profitability is usually represented in dollar figures, the data would be readily attainable. Using dollar figures in a graph already measured totally by percentages seemed inconsistent, so the next step was to choose gross profit margin. The variable is thus an indication of profitability only in percentage form and in compliance with the original measures in the three-dimensional model.

Description of Data Used

In considering what data to use for this model, certain decisions had to be made. There were several levels that could be chosen:

1. The basic divisional categories the company is organized into: (a) grocery products, (b) agricultural products, (c) restaurants, and (d) diversified businesses. This was the most obvious breakdown to work with, as all of the figures in the annual report are broken into these categories. An obstacle which kept arising was, what is the market share of each category?
2. The various products which the company produces. The availability of data on separate products was not readily accessible from the annual report.
3. The product lines in general. Although not readily available, this is the data which was finally chosen. Within each division category are several general product lines which can be identified, as follows:
   a. Grocery products
      Pet foods
      Sea foods
      Other grocery products
   b. Agricultural products
      Animal and poultry feeds
      Soybean meal and oil
      Other agricultural products
   c. Restaurants
      Fast-food
      Specialty houses
   d. Diversified businesses

- Resorts
- Hockey franchise
- Mariculture
- Protein production
- Food service
- Direct selling
- Contract scientific services

As indicated above, the product line data was chosen for this report. The above list of possible product lines is quite long and, in fact, some could be even further broken down. With this in mind and the limitations of a three-dimensional figure, only two product lines were chosen for graphing. These two product lines are pet foods and animal and poultry feeds. Although from different divisional categories, they are representative of two different positions in the portfolio model.

The data used is from the 1980 Annual Report of Ralston Purina Company, *Standard & Poor's Register*, and *Moody's Industrial Manual*. Market growth was based on the percentage of change in annual sales as shown in Tables 1 and 2.

Table 1

ANNUAL SALES
($ Millions)

Product Line	1980	1979	1978	1977
Pet foods	1,139.6	986.0	892.3	776.0
Animal and poultry feeds	1,913.5	1,826.4	1,532.1	1,473.2

Table 2

MARKET GROWTH
(Percentage)

Product Line	1980	1979	1978
Pet foods	15.6	10.5	15.0
Animal and poultry feeds	4.8	19.0	4.0

The market share measure was based upon information received from sources within Ralston Purina and is shown in Table 3.

Table 3

MARKET SHARE
(Percentage)

Product Line	1980	1979	1978
Pet foods	38.0	38.0	50.0
Animal and poultry feeds	54.0	53.0	53.0

The third measure, gross profit margin, was based on figures taken from the 1980 Annual Report of Ralston Purina Company and shown in Table 4. The profit margins are as shown in Table 5.

Data Analysis

In the BCG approach, there are four quadrants measured by two variables. When a third variable is added, the quadrants become three-dimensional, running as rectangular boxes front-to-back.

Table 4

CROSS PROFIT
($ Thousands)

Product Line	1980	1979	1978
Pet foods	111.2	115.6	118.0
Animal and poultry feeds	113.5	104.9	142.2

Table 5

GROSS PROFIT MARGIN
(Percentage)

Product Line	1980	1979	1978
Pet foods	63.8	62.6	63.5
Animal and poultry feeds	80.0	79.5	76.5

The points plotted for 1978 and 1980 in Figure 2 for the animal and poultry feeds line show this product line as a cash cow. This is representative of this particular line. The animal and poultry feeds line is the mainstay and a cash generator for the other questionable lines throughout the company. What happened to the 1979 point? The figures are correct as to growth but do not take into account that during 1979 the sales and earnings were not as large as they should have been. This was due to the sale of Ralston's majority share of various Mexican subsidiaries.[6] As a result of this ownership reduction, the last three months of sales and earnings from these subsidiaries are not reflected in the annual report. So the plotted jump from cash cow to star back to cash cow is inconsistent with the real standing as having always been a cash cow.

Figure 2
THREE-DIMENSIONAL MODEL: ANIMAL AND POULTRY FEEDS

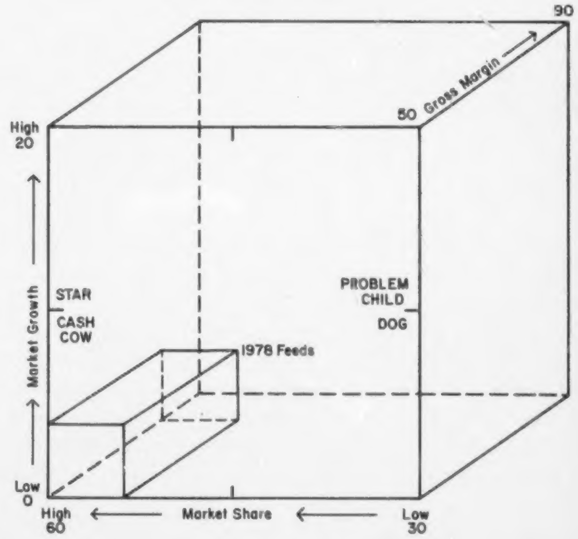


Figure 2 (cont'd)

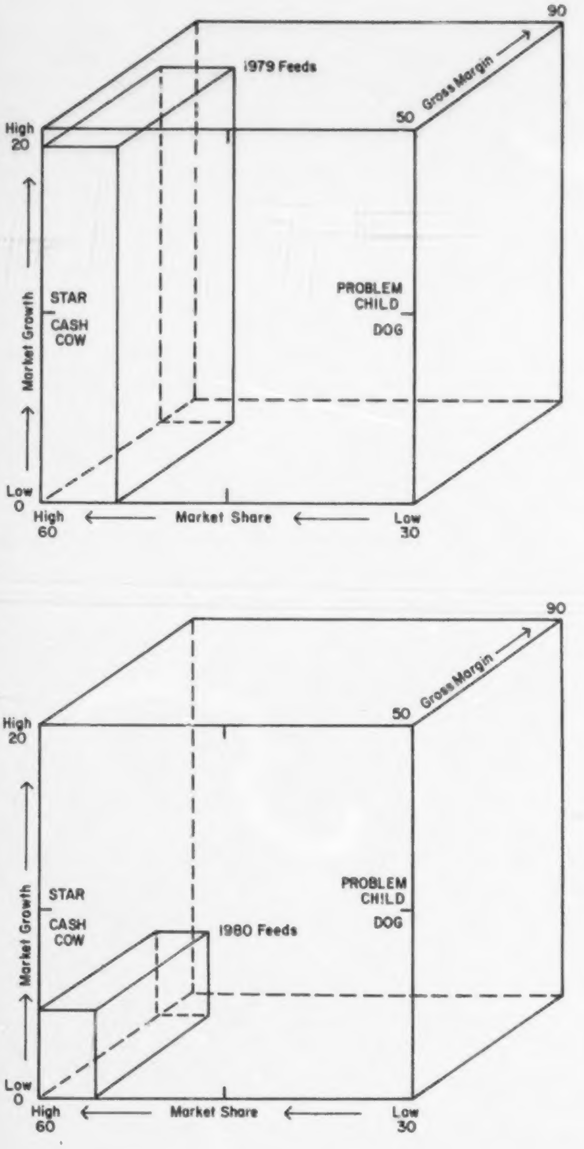
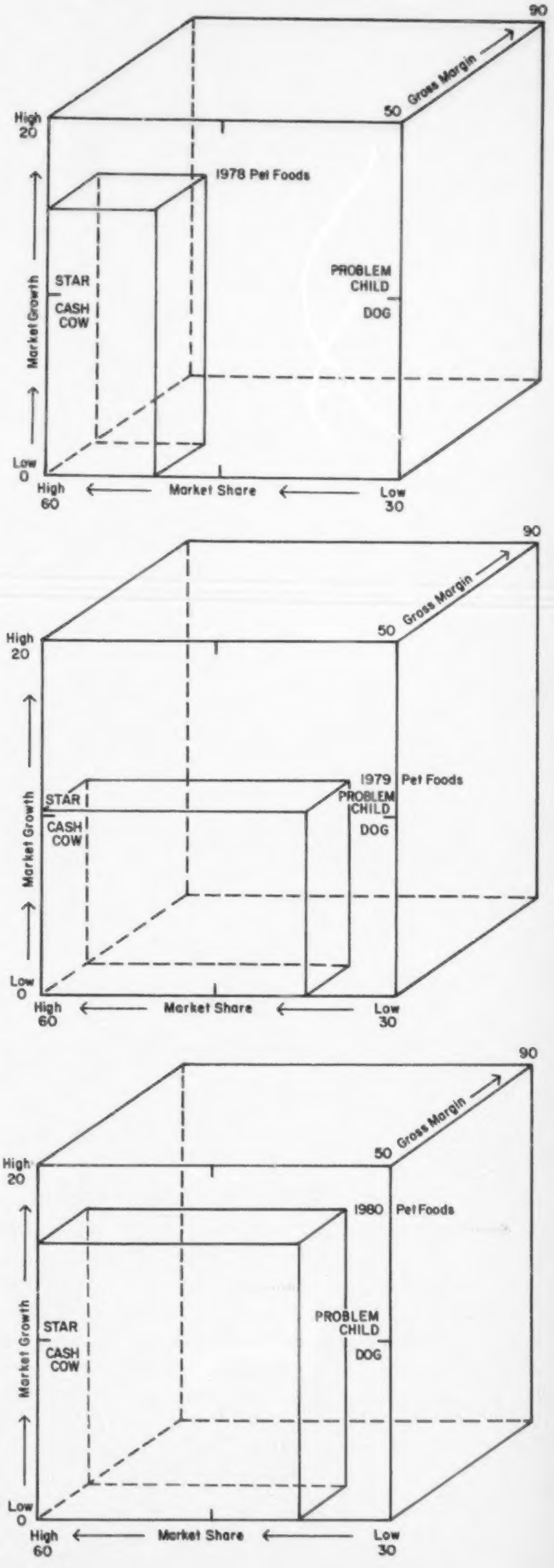

90
1979 Feeds
50
Gross Margin
High 20
Market Growth
Low 0
STAR
CASH COW
PROBLEM CHILD
DOG
High 60
Market Share
Low 30
90
50
Gross Margin
High 20
Market Growth
Low 0
STAR
CASH COW
PROBLEM CHILD
DOG
1980 Feeds
High 60
Market Share
Low 30

Figure 3
THREE-DIMENSIONAL MODEL: PET FOODS


90
50
Gross Margin
High 20
1978 Pet Foods
Market Growth
STAR
CASH COW
PROBLEM CHILD
DOG
Low 0
High 60
Market Share
Low 30
90
50
Gross Margin
High 20
Market Growth
1979 Pet Foods
STAR
CASH COW
PROBLEM CHILD
DOG
Low 0
High 60
Market Share
Low 30
90
50
Gross Margin
High 20
1980 Pet Foods
Market Growth
STAR
CASH COW
PROBLEM CHILD
DOG
Low 0
High 60
Market Share
Low 30

As plotted in Figure 3, the pet food product line would be considered a problem child, or question mark, since it falls in that quadrant in both 1979 and 1980. Initially, however, in 1978, the pet food line was unmistakably a star. How and why did this happen? The answer is that in 1979 competitors made a major offensive into pet foods, reducing Ralston's market share. Within 18 months Ralston's market share was reduced from 50 to 38 and thus the change in quadrants.[7] Profits dropped slightly from 1978 to 1979 and returned to surpass the 1978 level in 1980. However, Ralston does not consider its pet food line as a problem child. The company feels that it is a star, since its own earnings support the line without additional cash inflows from other sources.

Conclusion

The portfolio strategy model discussed here can be an important marketing tool. Products can be classified quite differently depending upon the model, dimensions, measurements, and data. As previously indicated, there must be more in-depth data available to make relevant and precise measurements, in order for the variables to be accurately applied.

The growth-share matrix, as used by the BCG approach, is very rigid, without adaptability for other variables. Even with the additional dimension, the two original dimensions remain dominant. As discussed in this article, additional variables become significant only as the quadrant system is expanded to allow for them. Unless this expansion is made to the categories in the Boston Consulting Group approach, allowing for the third dimension, the approach will be inadequate for portfolio planning.

One of the basic theories behind BCG's portfolio strategy is that cash cows support problem children, dogs, and stars. There is no optimal mix given, except that enough cash cows must be maintained to support the rest. Apparently the change in categories comes about through the natural course of the product's life. Independent decisions by management must be made as to whether a product looks potentially successful to change categories. There seem to be no specific guidelines for establishing the optimal portfolio. Also, there is no set definition of what the optimal levels are or how to attain them.

Although product portfolio strategy is not the cure-all for marketing and strategy planning, it can serve as a basis for an organized approach to opportunities and problems in the planning area. It is also apparent that no single, rigid approach or model can be applied to every firm. There must be more flexibility of dimensions to fit the corporate objectives of the firm involved. The model must be adaptable to the needs of the firm in order for it to truly reflect the position of the firm's products in the marketplace.

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[1] Philip Kotler and Keith Cox, *Marketing Management and Strategy* (Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1980), p. 32.

[2] "Unless You Can Be a Winner, Don't Play," *Forbes*, Oct. 15, 1977, p. 26.

[3] George S. Day, "Diagnosing the Product Portfolio," *Journal of Marketing*, April 1977, p. 31.

[4] Ibid., p. 36.

[5] E. Jerome McCarthy, *Basic Marketing: A Managerial Approach* (Homewood, Ill.: Richard D. Irwin, Inc., 1981), p. 308.

[6] Ralston Purina Company Annual Report (St. Louis, Mo.: Ralston Purina Company, 1980), p. 28.

[7] "Ralston Purina: Turnabout at the Top of Checkerboard Square," *Business Week*, Sept. 10, 1979, p. 112.

LINE-MANAGEMENT ATTITUDES TOWARD PARTICIPATIVE BUDGETING

Richard T. Cherry, Richard W. Jones, and
Eugene W. Arnold*

There exists some substantial disagreement among both academicians and practitioners as to the effectiveness of participative budgeting, i.e., the systematic involvement of all levels of management and supervision in the budgeting process. Most standard textbook treatments of the budgeting process focus on the behavioral benefits of management participation in planning, most commonly in terms of motivation and attitude.[1] Other writers, however, question the benefits, pointing to the stigma associated with failure to meet budget objectives and the resulting negative effects on morale and performance.[2]

According to Welsch, managers tend to tie their own personal success to that of the firm, and will strive aggressively to attain known, realistic objectives, particularly if they are allowed to participate in a meaningful way in the development of those objectives.[3] G.H. Hofstede summarizes the results of his study as showing that participation in budget setting "leads to higher motivation to attain the budgets," and "affects both the relevance and attitude component of motivation positively."[4] Ken Milani surveyed 88 foremen at a large heavy equipment plant and found that participation in budget setting related well to foremen's attitudes.[5] And Ernest C. Miller cites agreement among companies involved in a study on participative budgeting that "participation tends to increase commitment; commitment tends to heighten motivation; . . . [and] managers work harder and more productively."[6]

Even the proponents of participative budgeting, however, emphasize that token participation is likely to create negative motivation. Skeptics see this negative motivation and the potential morale problem as the Achilles heel of participative budgeting as it is actually practiced. Budgets, they allege, have a way of keeping managers constantly on the defensive. If they are not defending their performance under the current budget, they are defending their budget proposal for the coming year. The resulting stress, they claim, lowers morale, which in turn affects performance.

Conrad writes of the stigma, the harassment, and "even embarrassment" experienced by the manager who exceeds his budget. He goes on to describe what he calls the "antithetical manager" who learns from experience to see that the budget reflects goals he knows he can meet under the most adverse circumstances.[7] Henry L. Tosi, Jr., claims that budgets create anxiety and negative feelings of hostility.[8] And Lawrence M. Matthews cites approvingly "Stan's Law of Budgeting" to the effect that "budgeting is the uniform distribution of dissatisfaction."[9]

How acute, in fact, is the morale problem generated by the budgeting process? If budgeting is, indeed, "the uniform distribution of dissatisfaction," this dissatisfaction should be measurable in the attitudes of middle and line management personnel who are directly involved in the budgeting process. The purpose of this study was to sample the attitudes toward participative budgeting of line managers from a broad spectrum of business firms in the United States.

Survey Design

Prospective survey participants were drawn from a list of names and addresses obtained from Research Projects, Inc., of Hempstead, New York. The list consisted of managers at all levels and from all sizes of firms. Titles of listees were checked to exclude those in staff positions (i.e., accountant, analyst, or controller). In addition, the first question on the survey questionnaire was designed to establish whether or not the respondent had ultimate responsibility of budget preparation for a line department or other cost center in the firm.

A total of 1,000 questionnaires were mailed to listees fitting the preceding description. Approximately 12 percent were returned. After elimination of respondents who indicated staff responsibility or a title inappropriate to the desired sample characteristics, along with questionnaires that had defective or incomplete answers, 96 questionnaires were used to tabulate the survey results.

The survey questions fell into two broad categories: (1) those reflecting the general attitude of the respondent toward the budgeting process in his or her firm, and (2) those reflecting complaints concerning the conduct of budgeting in the firm. Each question required a scaled response ranging from 1 to 10 to gauge the intensity of the respondent's feelings or the degree of certainty regarding a particular condition. In each case, the response numbers were arranged so that a higher number represented a response favorable to the budget process, while a lower number indicated an unfavorable response.

Survey Results

Table 1 shows the key statements used in the general attitudes section of the questionnaire, along with the

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The authors are, respectively, Professor of Finance, Lamar University, Beaumont, Texas; Professor of Accounting, Lamar University, Beaumont, Texas; and Vice President for Finance, Hurricane Steel Corporation, Houston, Texas.

mean (average) response to each question and the modal (most frequent) response to that question. Also shown is the standard deviation of the responses. The standard deviation is a measure of the scatter or dispersion of the answers supplied, and thus can be taken as an indication of the degree of agreement among the managers surveyed regarding that issue.

Table 1

GENERAL ATTITUDE STATEMENTS

	Mean	Standard Deviation	Mode
Budgeting is essential to effective management at all levels within firm.	8.0	1.5	8.0
The budget is a valuable management tool used in the operation of your area of responsibility.	7.5	1.6	9.0
Budget preparation is one of the most important parts of your job.	6.3	2.2	7.0
Top management of your firm totally supports the budget program.	8.0	1.2	9.0

Almost two out of three (64 percent) of the managers surveyed said that budgets were essential to the effective operation of the firm at all levels. Significantly, none disagreed. About 12 percent fell into the "indifferent" to "mild disagreement" range of the response scale.

As to the actual use of the budget in the management of the respondent's area of responsibility, the distribution of the managers' answers was bimodal. The largest percentage (40 percent) agreed strongly. About 30 percent fell into the "mild agreement" category, while about 6 percent of the responses indicated "mild disagreement."

The importance of budgeting within their overall job responsibilities showed the widest disagreement of any of the responses. The dominant response in terms of frequency was "mild agreement" (36 percent). Over a quarter (26 percent) of the respondents disagreed or disagreed strongly that budgeting was an important part of their jobs. About 18 percent indicated "strong agreement" with the statement.

The statement drawing the most consistent positive response was that concerning top management support of the budgeting process within the firm. About 55 percent of the managers surveyed indicated "strong agreement," while about 42 percent of the responses fell into the "indifferent" to "mild agreement" range. There were no responses in the "disagree" or "disagree strongly" range.

Table 2 provides a correlation matrix, showing the extent to which responses to each question coincided with other general attitude questions. As expected, those managers who consider budgets essential to effective management were also, for the most part, those who viewed budgeting as an important part of their own job responsibilities and who actually used the budget in the operation of their departments.

Most striking, however, is the low correlation between the respondents' perception of top management support for the budgeting program and their attitudes toward the importance of budgeting. This unexpected result is in direct contrast to the importance placed upon top management support in the academic literature.[10]

The second part of the questionnaire asked line managers to indicate agreement or disagreement with some common criticisms of the budgeting process in many firms, specifically:

1. Too much detail required
2. Forms are unsatisfactory
3. Frequent changes in forms, procedures, etc.
4. Failure to provide adequate historical data
5. Lack of cooperation from other departments

Table 2

CORRELATION MATRIX OF RESPONSES
TO GENERAL ATTITUDE QUESTIONS

	Essential	Actually used	Important	Management support
Essential	1.00			
Actually used	.75	1.00		
Important	.71	.55	1.00	
Management support	.30	.31	.30	1.00

Table 3 shows the average and modal response to each statement, along with the standard deviation of the responses to each statement as an indication of the extent of agreement among line managers surveyed regarding each complaint. The response scale was arranged so that a high number conveys disagreement with the complaint (i.e., general satisfaction with the indicated aspect of the budget process in one's firm), while a low number indicates agreement with the complaint.

Table 3

COMPLAINTS

	Mean	Standard Deviation	Mode
Too much detail required	5.9	2.0	6.5
Unsatisfactory forms	6.4	1.8	6.5
Frequent changes in forms, procedures, etc.	5.9	1.8	6.5
Inadequate data supplied	7.4	2.0	8.5
Cooperation from other departments is inadequate	8.0	1.2	8.5

Interestingly, none of the complaints receives any broad validation among the respondents. The modal (most frequent) reaction to all of the complaints varies from mild disagreement that the complaint is valid to strong disagreement regarding the validity of the complaint in their firms. The standard deviations of the responses are generally larger, however, indicating less agreement among the respondents regarding the validity of the complaints than was present in the responses to general attitude questions.

Budget forms seemed to draw the largest negative response. About 25 percent of the managers surveyed said the forms required too much detail. The same percent characterized the forms, overall, as unsatisfactory. About 33 percent said the forms were changed too frequently. In each case, however, almost one-half of the respondents found no significiant fault with budget forms.

The strongest positive response related to the adequacy of information supplied to aid in budget preparation and to cooperation from other departments. Only 12 percent of the respondents expressed dissatisfaction with the amount or quality of data provided. The response regarding interdepartmental cooperation was overwhelmingly favorable. Not a single respondent reported cooperation from other departments as unsatisfactory.

Table 4

CORRELATION MATRIX OF RESPONSES
TO COMPLAINT STATEMENTS

	Too much detail required	Unsatis-factory forms	Fre-quent changes	Inade-quate info.	Inter-dept. coop.
Too much detail required	1.00				
Unsatisfactory forms	.13	1.00			
Frequent changes	.24	.52	1.00		
Inadequate information	.07	.12	.23	1.00	
Interdepartmental cooperation inadequate	- .22	.10	0	.30	1.00

Discussion

Despite the existence of substantial skepticism in the literature, and among some practitioners, regarding the budgeting process, line managers display a surprisingly favorable consensus regarding the importance of budgeting. Almost two out of three respondents agreed that budgets are essential to effective management, and almost three out of four said they actually use their budgets in the day-to-day operation of their area of responsibility.

In contrast to the wide recognition of the usefulness of budgets is the view of survey respondents concerning their own role in budgeting. About one-third saw budgeting as an important part of his or her managerial responsibilities, while one in four indicated strongly that budgeting was not an important part of his or her job. Almost 40 percent of the managers surveyed seemed unsure or ambivalent regarding their role in the budget process.

This result may be related to the surprising absence of any relationship between the view of respondents as to the importance and usefulness of budgeting and their perception of top management support for the budgeting program. Any explanation for this puzzling disparity must remain a matter of speculation as far as specific survey results are concerned. However, the following hypotheses are consistent with the attitude information supplied by the survey responses:

1. What the respondents perceive as top management support may be predominantly verbal as opposed to systematic and operational. This would explain the widespread uncertainty among the managers surveyed as to how budgeting fits into their own managerial responsibilities.

2. Since effective participation in budgeting is hardly possible in the presence of uncertainty among line managers as to what their role is, it seems likely that there is widespread "token" participation.

3. Extensive token participation, coupled with the apparent broad appreciation of the importance of budgeting, would imply that the adverse effects on morale said to accompany token participation are overstated.

The generally positive attitudes of line managers toward budgeting exist in spite of complaints about specific features of the budgeting process. A number of features of the pattern of responses to the complaint section of the questionnaire seem significant.

First, no single complaint is universal, but there are significant "pockets" of dissatisfaction with the amount of detail required, the format of the budget forms used, and with the frequency of changes in forms and procedures. Second, the validity of the complaints is given some support from the absence of correlation among complaints. The low intercorrelations imply the absence of complete hostility, i.e., respondents who complained about all aspects of the budgeting process.

Conclusions

The following conclusions seem to be justified in terms of the responses to the survey:

1. The attitudes of line managers, as a whole, seem to be distinctly positive to the budgeting process. Line managers understand the importance of budgeting, and they use their budgets in the operation of their areas of responsibility.

2. Complaints center on the mechanical aspects of the budgeting process, especially the amount of detail required, the format of budget forms used, and the frequency with which forms and procedures are changed.

3. The complaints, however, seem to be company-specific, i.e., there was no single complaint that received widespread support by any substantial percentage of the respondents, and there was very little correlation between complaint elements.

4. The quality and quantity of data supplied managers to aid them in budget preparation, and the cooperation of other departments within the firm, received overwhelming approval by the respondents to the questionnaire.

In addition to the conclusions noted above which received direct support from the survey data, there are some tentative, but important, implications of the survey findings:

1. Survey respondents seem to be quite ambivalent as to how they perceive their own individual role in the budgeting process. At the same time, they report overwhelmingly that top management of their firms totally supports the budgeting program.

2. This implies that the management of some firms may support budgeting in the form of well-publicized pronouncements of that support, but may fail to follow up with systematic operational procedures for involving line managers meaningfully in the budget process.

3. If these inferences are correct, the broad positive attitude toward budgeting itself on the part of line managers seems to imply that the adverse effects of "token" participative budgeting have been overstated.

These conclusions point to specific points of inquiry that may yield high returns in those firms seeking to improve the effectiveness of their budgeting programs:

1. Is top management support for profit planning in the firm visible and clear-cut?

2. Has that support been embodied in written policies and guidelines that make specific the responsibility and scope of line management participation in the budgeting process?

3. Is the amount of detail required in departmental budgets consistent with the real needs of the budgeting procedure?

4. How frequently are forms and procedures changed? Are the changes meaningful?

5. Could budget forms and procedures benefit from the input of line managers who have to use them? Is there a procedure for obtaining this input?

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[1] See, for example, Glenn A. Welsch, *Budgeting: Profit Planning and Control*, 4th ed. (Englewood Cliffs: Prentice-Hall, Inc., 1976), especially pp. 30-32.

[2] For example, see Robert B. Conrad, "The Antithetical Manager and Why He Succeeds," *S.A.M. Advanced Management Journal*, January 1974, p. 14.

[3] Welsch, p. 31.

[4] G.H. Hofstede, *The Game of Budget Control* (London: Tavistock Publications, Ltd., 1968), p. 191.

[5] Ken Milani, "The Relationship of Participation in Budget-Setting to Industrial Supervisor Performance and Attitudes: A Field Study," *Accounting Review*, April 1975, pp. 280-82.

[6] Ernest C. Miller, *Objectives and Standards: An Approach to Planning and Control*, AMA Research Study 74 (New York: American Management Association, Inc., 1966), p. 38.

[7] Conrad, p. 14.

[8] Henry L. Tosi, Jr., "The Human Effects of Budgeting Systems on Management," *MSU Business Topics*, vol. 22, no. 4, pp. 56-57.

[9] Lawrence M. Matthews, *Practical Operating Budgeting* (New York: McGraw-Hill Publishing Co., 1977), p. 17.

[10] See, for example, Welsch, pp. 30-31.

RELATIONSHIP BETWEEN CORPORATE FINANCIAL PERFORMANCE AND EXECUTIVE AGE

*Letricia Gayle Rayburn**

A widespread belief is that there is a negative relationship between advanced age and corporate financial performance. "Older" managers are often described as being tired and less effective. Young managers within an organization are often heard criticizing older managers for failing to use a variety of information in their thinking and for neglecting to develop a variety of alternatives or choices based on this information. Certainly individuals holding top positions in organizations and engaged in policy or strategy formation need the ability to differentiate among aspects of a complex problem and to integrate these different aspects in achieving a solution. If this ability tends to decline with age, the older manager who is in a top executive position may be lacking this needed characteristic. Older managers are also often considered to be less willing to try new approaches such as might be used in promotional activities.

Studies on Aging

Christopher Bagley's study of prejudice found that there is a significant tendency for subjects who are low on prejudice to be younger, better educated, and of a higher social class.[1] However, his findings revealed that even though the age difference is statistically significant, it is not very marked. He further tested the independent effects of age, occupation, and education, and found that when the effects of occupation and education are held constant, the stronger relationship is that between age and prejudice.

William J. McQuire indicates that there are several lines of evidence suggesting that aging or maturation of the person has some impact on his or her attitudes.[2] Since altered social role or accumulated experience as well as other nonphysiological factors have an impact, not all age-related attitude change need be due to physiological aging per se. McQuire suggests that several lines of research indicate that as one progresses through the ages, one's attitude orientation goes through a regular metamorphosis from the negativeness of the three-year-old to the conservatism of old age. Longitudinal studies of child development suggest that as individuals mature, there are systematic shifts in their mean level of dominance, aggressiveness, competitiveness, conformity, independence, and other general attitude tendencies.

In addition to research on aging, many studies have also been conducted analyzing the characteristics of individuals who play an important role in corporate policy formation. Bradish[3] studied the academic background of corporate top managers, including chairmen of the board, presidents, and executive vice presidents, and his studies yield the following diverse list:

Engineering and Science	28%
Industrial Management	14%
Accounting	13%
Liberal Arts and Social Service	13%
Law	9%
Marketing	5%
Economics	5%
Miscellaneous	13%

Similarly, Pohl[4] found a diversity of functional background experience of chief executives:

Finance	24%
Marketing	23%
General Administration	14%
Law	12%
Manufacturing	8%
Engineering and Scientific	6%
International	1%
Other	12%

The conclusions of most of these studies are that there is no one functional area of experience or one university curriculum major that will provide all the knowledge needed. Certainly it appears evident that the more knowledge one has that is relevant to on-the-job decisions, the higher the degree of success the individual will have.

Research Issues

While results from other studies concerned with background and intelligence will be discussed as background material, the major research question concerns the impact of top executive age on financial performance of the corporation. The primary research issue is to explore the relationships between such financial factors as sales, net income, assets, earnings per share, and number of employees with age to determine if companies managed by older top managers do experience lower indicators of financial success. A second research question investigated is the relationship between the age of the top two executives and the amount of advertising expense incurred. The rationale underlying this study is that corporate policies and practices reflect the attitudes of the top

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**Professor of Accountancy and Director of Accountancy Graduate Studies, Memphis State University, Memphis, Tennessee.*

executives and that older executives are more likely to have conservative ideas and less extensive corporate advertising budgets.

A related research question concerns the impact of the industry upon age. Are there significant differences in the age profiles when considering the different industries? Do some industries consistently hire younger top executives or do more industries hire a mix of ages in their management team?

To gain an insight into the impact that age has upon financial performance, a study was made of the 1981 annual reports of the companies designated as the "Fortune 500 Largest United States Industrials." *Fortune* defines an industrial as a company which must derive more than one-half of its revenues from manufacturing and/or mining. Sales is used as the basis for determining the largest industrials; also the companies must be publicly owned. Certainly the inclusion of only the "Fortune 500" industrials does not imply that age has no impact on other areas of business such as banking and insurance; the exclusion of other companies was necessary to put a practical parameter on the survey.

The ages of the top two senior officers of the companies in the survey were obtained from the corporations' 10-K statements and through use of *Standard & Poor's Register, Corporations,* and *Standard & Poor's Register, Directors and Executives*. Only the ages of the top two executives of the "Fortune 500" industrials were used, because evidence in the past shows that the major policies and practices of corporations are shaped by a relatively small number of top managers.

As Table 1 indicates, the age of the first executive of 46 corporations in the "Fortune 500" industrial list could not be determined. Of the 454 ages available, the range was from 38 years to 82 years, with a mean of 58.43, a mode of 61.00, and a median age of 58.79. There were 64 ages of second executives missing, and the range for the 436 ages available was slightly larger, with the youngest being 38 years and the oldest 85 years. The mean was 55.09, the mode was 56.00, and the median was 55.32, all representing slightly younger ages than for the first executive.

Table 1

AGE PROFILES OF TOP EXECUTIVES

	Mode	Mean	Median	Range	Standard Deviation
First Executive (n = 454)	61.00	58.43	58.79	44	6.7
Second Executive (n = 436)	56.00	55.09	55.32	47	6.9

Role of Intelligence

Before considering the impact of age on corporate financial performance, this study considered intelligence and cognition capabilities, as these characteristics appear to be especially important in evaluating information and judging the potential impact of adverse consequences. Cognitive capabilities include the ability to search out and use a variety of information in thinking and to develop a variety of alternatives or choices based on this information. Cognitively complex people are able to effectively cope with interrelated problems. Individuals who are engaged in policy or strategy formulation, such as top executives, should benefit if they possess this cognitive style of thinking.

The role of intelligence is also closely related to the issue of knowledge; however, intelligence refers to the degree or extent to which an individual is ready to learn new things rapidly and solve problems correctly. Intelligence is an important ingredient of decision making because it permits the accumulation of relevant knowledge more rapidly and facilitates choosing among alternatives. As expected, studies have shown that the more successful managers are typically more intelligent.[5] Miner's study[6] showed that roughly three-quarters of the presidents are in the top 3 percent of the population and all are in the top 10 percent. The company officers in his study who were at a somewhat lower organization level scored almost as well.

Age and Financial Success

Using these studies as supporting evidence, it is plausible to assume that the differences of intelligence and education are not major when considering the two top executives of the "Fortune 500" industrials. The study then proceeded to compare management age with corporate financial success. Correlations of the average age of the top two executives of the *Fortune* top 500 industrials whose ages were available were made with the following seven financial indicators of success: sales, assets, total net income, net income as a percent of sales, net income as a percent of stockholders' equity, earnings per share in 1981, and percentage total return to investors. A Pearson Product-Moment correlation was used. Since the intent was to perform multiple regression analysis, the data for an industrial were used only if ages of both top executives were available; as a result, 409 cases were used in the correlation. Inspection of the correlation matrix revealed that all the correlations were low, with sales the highest and net income the lowest.

Multiple regression analysis revealed a low correlation between age and the seven financial success indicators, with earnings per share being the highest (with a coefficient of determination of only .00459). The multiple R was .06774 with seven variables in the equation.

When the ages of the top two executives were used as separate dependent variables in a multiple regression analysis with sales, assets, total net income, net income as a percent of sales, net income as a percent of stockholders' equity, earnings per share in 1981, and percentage total return to investors, low zero order correlations also resulted. There were 443 cases of the top executive ages. For the top executives, the highest coefficient of determination of .0045 existed between age and assets. The multiple R was .06710 with seven variables in the equation. Using only the age of the second executive, 428 cases were used in the multiple regression analysis. Net income as a percent of sales had the highest correlation of determination of .011, with a multiple R of .10483 with seven variables in the equation. These statistics indicate that the relationship between age and measures of corporate financial success is not strong.

Top Executives Over 65 Years of Age

Research in the past led to the conclusion that intelligence declines with age; however, more recent research has corrected the deficiencies in the research design so that indications are that there is a rise in average intelligence level at least to the age of 50. After age 50, there is a leveling off, but there is no decline, according to Matarazzo's studies,[7] at least through the usual retirement age in the mid-60s.

Of the top 100 *Fortune* industrials, only six had top executives who were past 65 years of age, while 11 over-65-years top executives were in the next 100 top group. Of those companies having a *Fortune* rank between 400 and 500, 20 firms had top executives over 65 years of age. To further examine this issue, the following null hypothesis was tested: There is no statistically significant difference between financial success of companies whose top executive is over 65 years of age and those companies with a younger top executive.

To test this hypothesis, sales, assets, net income, stockholders' equity, and number of employees of the 57 top "Fortune 500" industrials whose top executive was past 65 years of age were compared with the corresponding figures for the 393 companies whose top executive was 65 years or younger. While ages for 454 top executives were found, 450 ages were used in the Multivariate Analysis of Variance (MANOVA) test, because net income for three industrials in the study was not available. One of these companies was a cooperative, and this type of firm provides only net margin figures, which are not comparable to net income figures. Total assests and stockholders' equity were not available for another company.

As Table 2 indicates, the mean for all five variables is higher for the companies with a top executive 65 years or under. The standard deviation is also higher for this group than for the companies whose top executive is over 65 years.

Table 2

CORPORATE FINANCIAL PERFORMANCE BY AGE GROUPS

	Age of Top Executive	
	65 Years and Under	Over 65 Years
Sales		
Mean	$2,433,446,000	$1,368,618,000
Standard Deviation	5,277,972,000	1,891,754,000
Assets		
Mean	$1,794,043,000	$1,008,173,750
Standard Deviation	3,510,811,000	1,688,222,000
Net Income		
Mean	$ 906,347,438	$ 128,902,125
Standard Deviation	6,612,320,000	127,390,563
Stockholders' Equity		
Mean	$1,057,779,000	$ 876,479,687
Standard Deviation	1,810,010,000	817,305,375
Number of Employees		
Mean	$ 33,709,848	$ 25,037,313
Standard Deviation	59,139,668	49,274,270

Since the probability level for both the MANOVA and the Univariate F tests all exceeded .05, however, the null hypothesis was rejected.[8] Overall, no statistically significant difference in the set of five variables can be attributed to age.

Advertising Expense and Age

To gain additional insight into the impact of management age on corporate policy and financial performance, a bivariate correlation analysis was made of age and advertising expense. The rationale for this analysis was the assumption that the younger managers would have what might be termed broad or liberal attitudes with respect to promotional activities, so that their firms would be encouraged to advertise extensively. By contrast, older executives would have a more conservative set of attitudes and hesitate to spend larger sums in demand creation.

Only 137 "Fortune 500" companies for whom the ages of the top executives could be obtained had detailed advertising expense in their Form 10-K. One reason for this is Regulation SX-Rule 12-16 relating to Form 10-K filings with the Securities and Exhange Commission. The regulation indicates that only if advertising expense exceeds 1.0 percent of total sales and revenues does it need to be detailed and disclosed individually. The companies detailing advertising expense listed it in their supplementary income statement, while other companies included advertising expense in selling, general, and administrative expense.

With a significance of .30678, the bivariate correlation analysis showed that less than 1.0 percent of the variation in advertising expense could be explained by age of the top executive. A similar test using the age of the second executive in the organization showed an even lower coefficient of determination for the 137 companies studied. Thus, it can be assumed that age has little or no relationship to advertising expense.

Age and Industry

A comparison of age by industry groups was made. There are 28 industry codes indicated for the top "Fortune 500" industrials. The industry code indicated for each company represents the greatest volume of industrial sales. These categories were established by the United States Office of Management and Budget and issued by the Federal Statistical Policy and Standards Office.

As Table 3 indicates, a comparison of industries shows meaningful differences in ages of the first executives. When the 454 cases of top executives' ages are averaged by the 25 industries represented, the beverage industry has the youngest top executive, while the broadcasting, motion picture industry has the oldest top executive. On the average, the top executive of the beverage industry is 12 years younger than the top executive of the broadcasting,

MID-SOUTH ECONOMY

BUREAU OF BUSINESS & ECONOMIC RESEARCH THE FOGELMAN COLLEGE OF BUSINESS AND ECONOMICS MEMPHIS STATE UNIVERSITY

STATISTICAL SUPPLEMENT

THE MID-SOUTH ECONOMY

Data for the initial month of the fourth quarter of 1982 showed the continuation of a recessionary pattern in the national and Mid-South economies. Economic indicators continued to oscillate, showing no consistent evidence of a recovery or the ending of the downturn. Third quarter capacity utilization was 69.7 percent for the third quarter of 1982, with the industrial production index 11.4 percent below its peak level in July 1981. Durable goods production fell 15.4 percent from its July 1981 peak, while nondurables production was 6.5 percent below its August 1981 peak. Creating an additional drag on the American economy was the fact that we continue to import more merchandise than we export. The third quarter merchandise trade balance registered a $13.1 billion deficit. However, the continued softening in the interest rate and inflation picture has brought gains in consumer and business confidence. But these gains are still too modest and too recent to be convincing, and considering all the slack in the economy, there may be reason to expect some disappointment with the nation's economic performance over the next six months.

In the Mid-South, total personal income grew 6.9 percent from second quarter 1981 to second quarter 1982, slightly below the national increase of 7.2 percent. Aggregate sales tax collections remained sluggish, although retail sales in East South Central states rose an unadjusted 6.3 percent in October 1982. Also, major flooding hit the Mid-South states of Arkansas, Mississippi, and Louisiana during the quarter. All three of these factors appear to indicate that any prospect of a strong recovery in the Mid-South economy may be dampened by below average growth in personal income, reduced farm revenues, and lower than anticipated government revenue collections. One area of possible benefit to the Mid-South is the Reagan program for a build-up in our national defenses. A recent analysis by the Federal Reserve Bank of Atlanta showed that each of the Mid-South states (excluding Arkansas) ranked among the top five nationally in at least one of the 25 different Department of Defense procurement programs.

LABOR

The slack in the nation's industrial base is mirrored in the historically high unemployment figures. Unemployment is generally considered a lagging economic indicator because it has a tendency to continue to increase as the economy begins a recovery. Thus, unemployment is expected to remain high for the near term since those people who have previously become discouraged begin to re-enter the labor force once a recovery is underway. This results in an increase in the unemployment rate in the face of improved economic conditions.

The aggregate unemployment rate in the Mid-South was 11.7 percent in October 1982, a slight drop from the July 1982 rate of 11.9 percent but 3.1 percent higher than last October. The number of unemployed persons totaled 932,200 in October 1982, up 38.8 percent from a year ago, which represented an increase of only 800 people since July 1982. Total non-agricultural employment in the Mid-South fell 2.7 percent from last October, with manufacturing having 138,500 fewer jobs than a year ago. Non-manufacturing employment registered a slight decline of 0.7 percent.

The goods-producing sectors of the Mid-South economy continue to register declines. Hardest hit in the durable goods portion were primary metals, transportation equipment, machinery, and wood products. Alabama lost 10,700 jobs in its primary metals industry from the levels of a year ago, while Louisiana lost 6,200 jobs in its transportation equipment industry. Construction employment was generally down across the Mid-South with Louisiana having 11,500 fewer construction jobs than last October. However, Tennessee managed to register the only gain in construction jobs in the Mid-South, up 2,200 jobs from a year ago.

The Mid-South service-producing sectors registered mixed results. Tennessee lost 11,700 jobs in its trade industry and 8,900 jobs in government. However, the five Mid-South states managed to register an increase of 23,300 jobs in its services industry with Alabama, Arkansas,

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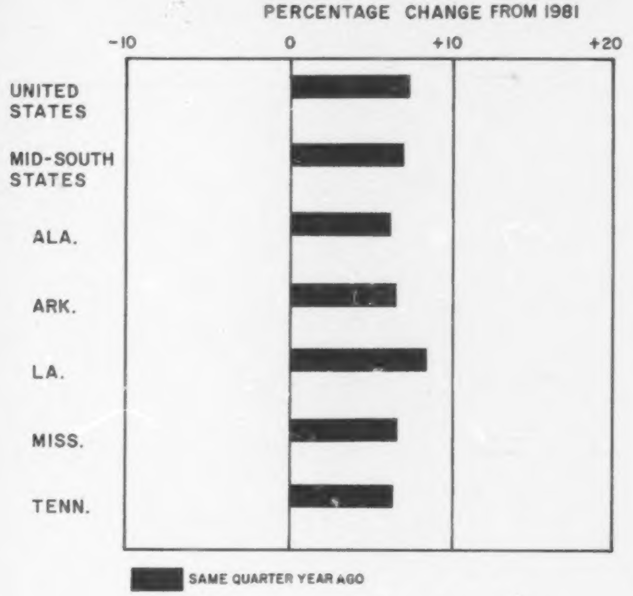
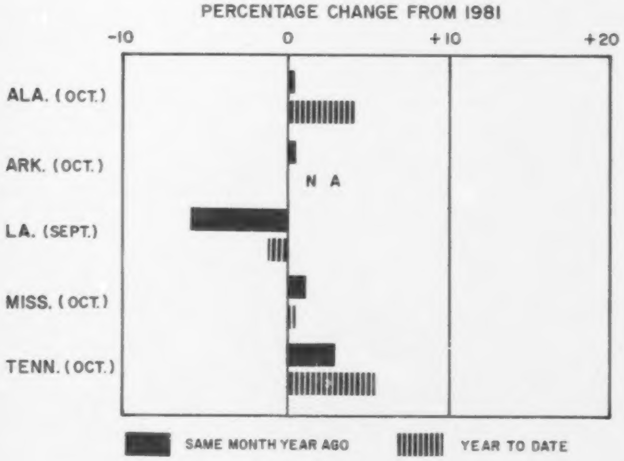
PERSONAL INCOME - II QTR 1982

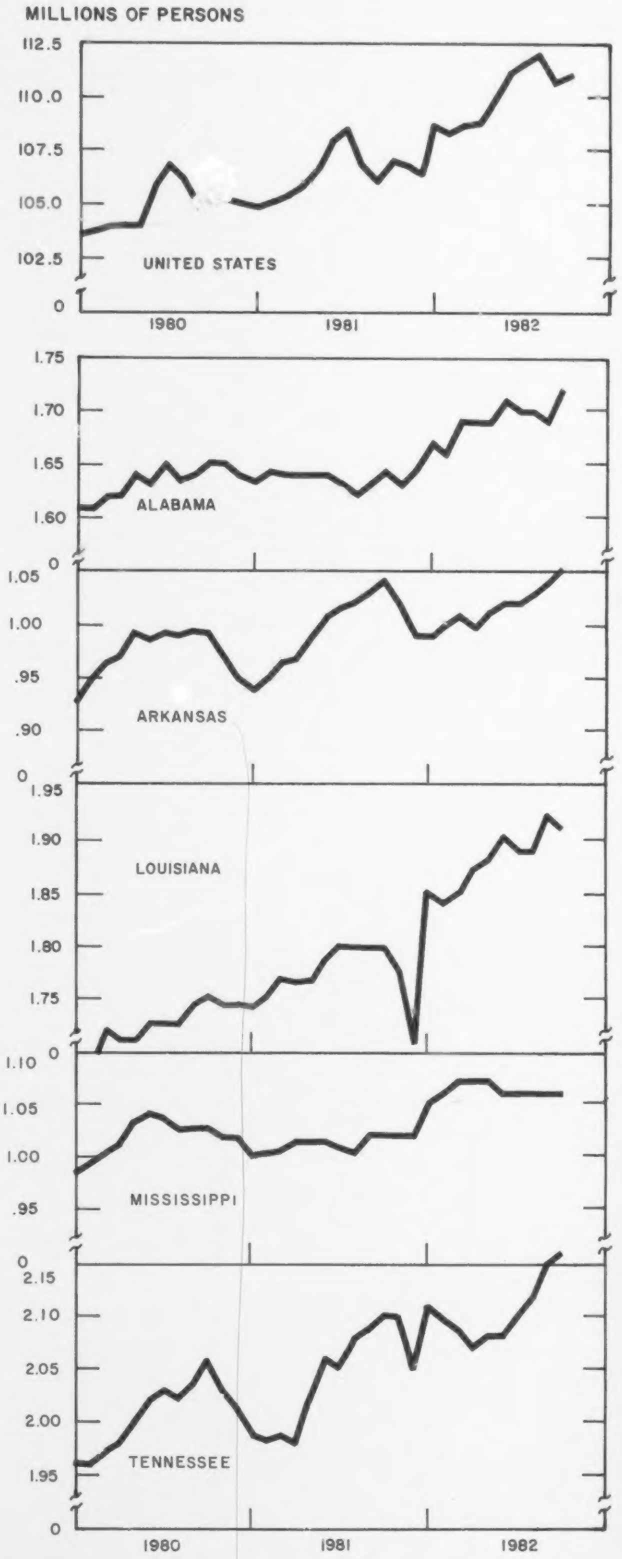


SOURCE: BUREAU ECONOMIC ANALYSIS

SALES TAX COLLECTIONS 1982



CIVILIAN LABOR FORCE



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and Louisiana experiencing an overall gain of 11,900 jobs in government employment.

CONSTRUCTION

For the 12 months ending September 1982, construction activity remains in contraction. Total building activity in the nation was 16.2 percent below the comparable 1981 period. The number of residential permits issued totaled 876,800 for the year ending September 1982, a 20.4 percent decline from a year ago.

Construction activity was substantially down across the board for most of the Mid-South, with Tennessee the only Mid-South state to register an increase in non-residential building. Alabama continues to be the hardest hit by the construction downturn with 49.0 percent fewer dwelling unit permits issued and a 44.7 percent drop in the dollar value of residential construction permits.

FINANCE

Commerical bank deposits in the nation rose 10.8 percent above last October with the component of time deposits increasing 16.2 percent. Most of the Mid-South

LABOR	United States (September)	Mid-South States				
		Alabama (October)	Arkansas (October)	Louisiana (October)	Mississippi (October)	Tennessee (October)
Civilian Labor Force	110,546,000	1,723,100	1,055,400	1,913,700	1,064,700	2,167,700
Percent Change Year Ago	+ 2.1	+ 2.2	+ 0.8	+ 1.3	+ 0.3	+ 1.8
Unemployed	10,695,000	258,500	101,400	208,400	129,700	234,200
Percent Change Year Ago	+35.6	+46.5	+19.9	+37.6	+59.9	+31.5
Unemployment Rate						
1982	9.7	15.0	9.6	10.9	12.2	11.2
1981	7.3	10.5	8.1	8.0	7.6	8.4
Non-Agricultural Wage & Salary Employees	89,038,000*	1,315,300	732,300	1,614,400	796,200	1,706,100
Percent Change Year Ago	- 2.5	- 3.0	- 2.2	- 2.1	- 3.6	- 2.9
Manufacturing Employment	18,576,000*	328,000	193,900	197,300	201,900	470,600
Percent Change Year Ago	- 8.3	- 9.2	- 8.3	-11.4	- 9.4	- 8.0
Non-Manufacturing Employment	70,462,000*	987,300	538,400	1,417,100	594,300	1,235,500
Percent Change Year Ago	- 0.9	- 0.7	+ 0.2	- 0.7	- 1.5	- 0.7
Average Weekly Earnings of Production Workers in Manufacturing	$333.29	$289.52	$265.95	$377.20	$255.82	$281.46
Percent Change Year Ago	+ 3.4	+ 1.7	+ 5.6	+ 1.6	+ 6.3	+ 3.4
Average Weekly Hours of Production Workers in Manufacturing	38.8	40.1	39.4	40.0	39.6	39.2
Percent Change Year Ago	- 1.8	0.0	- 0.5	- 6.5	+ 0.5	- 1.7
Average Hourly Earnings of Production Workers in Manufacturing	$8.59	$7.22	$6.75	$9.43	$6.46	$7.18
Percent Change Year Ago	+ 5.3	+ 1.7	+ 6.1	+ 8.8	+ 5.7	+ 5.3

*Seasonally adjusted.

Source: Departments of Employment Security and Survey of Current Business.

CONSTRUCTION[1] September 1982	United States	Alabama	Arkansas	Louisiana	Mississippi	Tennessee
Total Building						
Percent Change Year Ago	-16.2	-24.5	N.A.	- 5.5	-17.1	- 3.8
Residential Building						
Percent Change Year Ago	-20.9	-44.7	N.A.	- 7.6	-27.0	-13.6
Non-Residential Building[2]						
Percent Change Year Ago	-12.2	- 6.3	N.A.	- 4.1	- 5.1	+ 4.7
Total Dwelling Unit Permits						
Percent Change Year Ago	-20.4	-49.0	N.A.	-10.5	-26.8	- 7.3

[1] Twelve-month cumulative rate.

[2] Non-residential data exclude the cost of construction for publicly-owned buildings.

Source: Federal Reserve Bank of Atlanta from data supplied by the Bureau of the Census.

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states experienced similar patterns in their banking activity data except Arkansas which registered the lowest growth in total deposits and a decline of 11.9 percent in demand deposits.

Mortgage loans made by Mid-South savings and loans totaled $198.5 million in October 1982. All five Mid-South states experienced substantial increases from their October 1981 levels, but four of the five Mid-South states registered declines for comparable year-to-date levels. Arkansas was the only Mid-South state to register a gain, up 42.3 percent.

FINANCE 1982	United States (October)	Mid-South States	Alabama (October)	Arkansas (September)	Louisiana (October)	Mississippi (October)	Tennessee (October)
Member Banks as of 10/6/82 Percent Change from Comparable Date 1981							
Total Deposits	+10.8	N.A.	+6.8	+ 4.9	+11.0	+11.1	+11.7
Demand Deposits	+ 0.8	N.A.	+2.9	-11.9	- 1.6	+ 0.3	+ 4.3
Time Deposits	+16.2	N.A.	+7.8	+12.1	+15.7	+12.6	+14.4
Savings Deposits	+ 2.3	N.A.	+1.9	N.A.	+ 3.3	+ 2.8	+ 1.0

Source: Federal Reserve Bank of Atlanta and the Federal Reserve Bank of St. Louis.

SAVINGS AND LOAN ACTIVITY October 1982	Alabama	Arkansas	Louisiana	Mississippi	Tennessee[1]
Mortgage Loans Made (millions)	$20.0	$45.9	$91.2	$16.6	$24.8
Percent Change Year Ago	+ 57.5	+129.5	+62.3	+ 38.3	+ 37.6
Percent Change Year-to-Date	- 29.3	+ 42.3	- 9.0	- 47.2	- 35.7
Net Savings Flow (millions)[2]	($14.7)	($19.2)	$61.1	($ 9.7)	($ 1.2)
Percent Change Year Ago	-176.2	-972.7	+80.8	-980.0	- 70.8
Percent Change Year-to-Date	+379.4	+589.5	+51.3	+164.5	+337.9

[1] Figures are for total loans made.

[2] Net savings flow equals new savings received plus dividends credited minus savings withdrawn.

Source: Federal Home Loan Banks of Little Rock, Cincinnati, and Atlanta.

TENNESSEE ECONOMY

Tennessee's civilian labor force totaled 2,167,700 in October 1982, up 1.8 percent from a year ago. The total number of persons unemployed increased 56,100 from last October, a jump of 31.5 percent, placing Tennessee's 11.2 percent unemployment rate the third highest in the Mid-South. According to a recent report by the Tennessee Department of Employment Security, initial unemployment claims rose by 1,901 in November 1982 to a total of 63,104. In addition, 8,813 persons received their final unemployment checks in November, while 5,211 new job openings were available.

Total personal income rose 6.3 percent from second quarter 1981 to second quarter 1982 trailing the national increase of 7.2 percent. Sales tax collections were up moderately, increasing 5.3 percent above comparable year-to-date figures. Meanwhile, the Tennessee Department of Economic and Community Development reports that new plants and expansions totaled 31 in September, the second highest number of total projects since 38 in April 1978.

Total commercial bank deposits rose 11.7 percent from last October, outpacing the national increase of 10.8 percent. Time deposits accounted for the largest portion of the gain, up 14.4 percent from a year ago. Credit unions in Tennessee also experienced substantial growth, with savings and time deposits up 20.0 percent from last October and NOW accounts jumping 77.0 percent.

Total deposits at Tennessee's savings and loans rose 7.0 percent from a year ago to total $6.5 billion. The value of mortgage loans made was 37.6 percent above last October but 35.7 percent below the comparable year-to-date figure. Net savings flow declined $1.2 million in October 1982 but managed to stay three times better than the comparable year-to-date level.

Tennessee experienced the lowest decline in total building activity and was the only Mid-South state to post an increase in the dollar value of non-residential permits. Hospital building activity was up 188.0 percent, with school building up 13.0 percent. Some improvement in the housing area is indicated by the fact that the St. Louis Federal Reserve Bank's index of permits of Tennessee registered a seasonally adjusted annual rate of change of 18.2 percent for the third quarter of 1982 over third quarter 1981.

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motion picture industry.

An even more meaningful difference occurs when the ages of the second executives are averaged by industry. As Table 4 shows, the leather industry's second executive is on average 18 years younger than the metal manufacturing industry's second executive. Ages of the second executives represent 21 industries and follow a pattern quite diverse from that of the top executives. For example, on the average, the broadcasting, motion picture industry has the oldest top executive and the next-to-youngest second executive, while the tobacco industry follows almost the reverse pattern. The apparel and the mining, crude-oil production industries tend to have older executives in the two top positions.

Table 3

AVERAGE AGE OF FIRST EXECUTIVE BY INDUSTRY CODE

Industry Code	Average Age	Standard Deviation	n
Beverages	52.00	8.29	9
Tobacco	55.67	14.47	3
Motor Vehicles	56.33	7.03	21
Aerospace	56.78	7.14	14
Electronics, Appliances	57.09	6.33	33
Metal Products	57.11	7.96	18
Soaps, Cosmetics	57.14	6.69	7
Food	57.33	7.89	54
Pharmaceuticals	57.53	6.08	17
Textiles, Vinyl Flooring	58.00	6.51	15
Petroleum Refining	58.03	6.62	26
Glass, Concrete, Abrasives, Gypsum	58.43	5.09	14
Chemicals	58.71	4.59	39
Leather	59.00	0.00	1
Measuring, Scientific Photog. Equip.	59.00	5.76	13
Office Equipment (includes computers)	59.10	4.15	10
Industrial & Farm Equipment	59.13	8.38	45
Shipbuilding, RR & Transp. Equip.	59.43	4.35	7
Paper, Fiber and Wood Products	59.50	7.32	30
Publishing, Printing	59.60	5.34	10
Rubber, Plastic Products	59.63	6.76	8
Metal Manufacturing	60.47	4.99	30
Furniture	60.50	4.95	2
Mining, Crude-Oil Production	60.90	8.03	10
Miscellaneous	62.00	0.00	1
Musical Instr., Toys, Sporting Goods	62.75	6.40	4
Apparel	64.30	6.45	7
Broadcasting, Motion Pic. Prod.& Dist.	64.33	9.40	6
Mean =	58.44		n = 454

Table 4

AVERAGE AGE OF SECOND EXECUTIVE BY INDUSTRY CODE

Industry Code	Average Age	Standard Deviation	n
Beverages	57.55	6.78	9
Tobacco	57.80	2.77	5
Motor Vehicles	52.63	6.34	19
Aerospace	54.43	10.40	14
Electronics, Appliances	55.20	5.84	30
Metal Products	55.05	7.28	20
Soaps, Cosmetics	52.50	6.02	6
Food	55.77	6.50	48
Pharmaceuticals	55.40	5.89	15
Textiles, Vinyl Flooring	56.09	7.75	11
Petroleum Refining	54.66	5.72	30
Glass, Concrete, Abrasives, Gypsum	54.71	4.83	14
Chemicals	54.70	8.75	38
Leather	39.00	0.00	1
Measuring, Scientific Photog. Equip.	56.46	7.71	13
Office Equipment (includes computers)	54.60	7.81	10
Industrial & Farm Equipment	55.11	6.56	45
Shipbuilding, RR & Transp. Equip.	54.14	5.49	7
Paper, Fiber and Wood Products	54.93	7.47	28
Publishing, Printing	56.75	6.48	8
Rubber, Plastic Products	52.50	6.46	8
Metal Manufacturing	57.84	5.80	26
Furniture	50.50	2.12	2
Mining, Crude-Oil Production	56.82	6.19	11
Miscellaneous	51.00	0.00	1
Musical Instr., Toys, Sporting Goods	52.50	10.79	4
Apparel	56.50	6.39	8
Broadcasting, Motion Pic. Prod. & Dist.	46.80	7.69	5
Mean =	55.09		n = 436

Table 5 gives the ranking of the youngest to the oldest executive by industry for the average age of the two top executives. Only if both ages of the top two executives were available was the company included in this analysis. When the one leather company is excluded, the motor vehicle top management team is on average four years younger than the metal manufacturing industry team.

Table 5

AVERAGE AGE OF TOP TWO EXECUTIVES BY INDUSTRY CODE

Industry Code	Average Age	Standard Deviation	n
Beverages	54.78	5.58	9
Tobacco	57.67	6.64	3
Motor Vehicles	54.05	5.77	19
Aerospace	55.60	6.75	14
Electronics, Appliances	56.07	3.80	29
Metal Products	56.11	5.74	18
Soaps, Cosmetics	54.83	5.53	6
Food	56.98	5.66	47
Pharmaceuticals	56.50	5.36	15
Textiles, Vinyl Flooring	57.13	4.93	11
Petroleum Refining	56.13	3.85	26
Glass, Concrete, Abrasives, Gypsum	56.77	3.91	13
Chemicals	56.86	4.42	37
Leather	49.00	0.00	1
Measuring, Scientific Photog. Equip.	57.73	5.47	13
Office Equipment (includes computers)	56.22	4.73	9
Industrial & Farm Equipment	57.01	4.44	43
Shipbuilding, RR & Transp. Equip.	56.78	3.65	7
Paper, Fiber and Wood Products	57.32	5.52	28
Publishing, Printing	58.25	5.48	8
Rubber, Plastic Products	56.06	3.80	8
Metal Manufacturing	58.90	3.85	24
Furniture	55.50	3.54	2
Mining, Crude-Oil Production	58.55	3.93	10
Miscellaneous	56.50	0.00	1
Musical Instr., Toys, Sporting Goods	57.63	7.55	4
Apparel	58.83	4.52	6
Broadcasting, Motion Pic. Prod. & Dist.	55.60	7.50	5
Mean =	56.71		n=416

Summary

Multiple regression analysis was used to compare corporate financial success with the average age of the two top executives as well as the two managers' ages separately. In all cases, the statistics indicate that the relationship between economic success and age is not strong. The results from the MANOVA and Univariate F tests comparing corporate financial success and age categories were also nonsignificant, indicating that there is no statistically significant difference between sales, assets, net income, stockholders' equity, and number of employees for companies whose top executive is over 65 years of age and those firms with a younger top executive. This supports the concept that older top executives do not suffer a decline in intelligence or capability.

As shown by this study, management age also has very little relationship to the promotional expenditures of a firm. This refutes the argument that younger managers

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have broader or more liberal attitudes which cause them to be less conservative in their advertising campaigns. It appears that factors other than age cause executives to spend a large share of their revenue dollar on demand creation.

When top management age was classified by industry, meaningful differences arose. Several industries employ older top executives and younger second-in-command executives, while other industries follow reverse patterns. Few industries follow consistent patterns of employing on the average either older or younger executives.

Knowledge concerning the relationship between age and corporate financial success is of importance in many aspects of the organization's operations. Younger managers within organizations are often heard arguing that older executives become less able to effectively cope with interrelated problems, and they use this argument to explain what they consider to be "irrational" thinking on the part of their older top executives. However, decisions may appear irrational to the younger, lower-level managers because they do not have all the information that the top manager has. Not only does knowledge concerning the impact of executive age on the economic success of the firm have applicability in organizational communication, but this information is of value in recruiting and promotions.

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[1] Neil Warren and Marie Jahoda, eds., *Attitudes* (Baltimore: Penguin Books, Inc., 1973), pp. 276-82.

[2] Ibid., p. 53.

[3] Richard D. Bradish, "Acountants in Top Management," *Journal of Accountancy*, June 1970, p. 51.

[4] Herman H. Pohl, "The Coming Era of the Financial Executive," *Business Horizons*, June 1973, p. 22.

[5] Edwin E. Ghiselli, *The Validity of Occupational Aptitude Tests* (New York: John Wiley & Sons, Inc., 1966); and John P. Campbell, Marvin D. Dunnette, Edward E. Lawler, and Karl E. Weick, *Managerial Behavior, Performance, and Effectiveness* (New York: McGraw-Hill Book Company, 1970).

[6] John B. Miner, *Intelligence in the United States* (Westpoint, Connecticut: Greenwood Press, 1973).

[7] Joseph D. Matarazzo, *Wechsler's Measurement and Appraisal of Adult Intelligence* (Baltimore: The Williams and Wilkins Company, 1972).

[8] The MANOVA test results showed a hotelling T of 8.773, an F of 1.739, 5.000 degrees of freedom for the hypothesis, and 444.000 degrees of freedom for the error, with a probability level of approximately .124. Univariate F test for sales was 2.274 with a probability level of .132; for assets, F was 2.759 with a P of .097; for net income, F was .786 with a P of .376; for stockholders' equity, F was .555 with a P of .457; and finally, for number of employees, F was 1.113 with a P of .292.

PROSPECTS FOR FUTURE ADVERTISING REGULATION: A VIEW FROM CAPITOL HILL

*James U. McNeal and Stephen W. McDaniel**

During the 1970s, federal regulation of American business grew at an unprecedented rate. The budgeted expenditures of the 56 agencies with major regulatory functions increased 400 percent during the decade—from $1.2 billion in 1971 to an estimated $6 billion in 1980.[1] One of the most highly regulated business activities during this period was advertising.

In the early 1980s, the pro-business Reagan administration set its sights on doing something about this regulatory burden in order to "get government off the backs of the people." Additionally, many Congressmen were voted into office using the same platform. The general public and business alike indicated a willingness to reduce the regulatory burden. Now, as the pruning has started and federal regulatory controls over business are purportedly being cut back, what are the prospects for this deregulation continuing through the 1980s? Will this deregulation trend apply to the traditionally heavily-regulated field of advertising? To gain some insight into these questions, a study was done of the federal lawmakers themselves. Over 200 U.S. Senators and U.S. Representatives were surveyed in order to get their views on the future regulation of advertising.

Background

Several federal regulatory agencies exercise jurisdiction over advertising. The major ones are as follows:

Securities and Exchange Commission: Has control over the advertising of public offerings of stocks and bonds.

U.S. Treasury Department's Alcohol Tax Unit: Has jurisdiction over the advertising of alcoholic beverages.

U.S. Postal Department: Has authority over fraudulent or obscene material sent through the U.S. mail.

Food and Drug Administration: Regulates sales promotions and other information contained on product labels.

Federal Trade Commission: The most significant federal regulatory force over advertising. The FTC has authority to police false or misleading advertising. It investigates questionable claims, issues complaints against offending advertisers, and also makes rules and regulations regarding advertising.

As deregulation of business in general, and advertising in particular, has occurred in the early 1980s, there have also been efforts to reduce the authority of these agencies. For example, the budget of the Federal Trade Commission is being reduced almost 20.0 percent between 1982 and 1984. In fact, the FTC chairman, James Miller III, is in agreement over reducing the authority of the FTC. He plans to narrow FTC authority over deceptive and unfair advertising, as well as decrease the substantiation required for advertising. Chairman Miller contends, "It is time to . . . specify the Federal Trade Commission's basic mission. . . . It is time Congress sets limits on what is now virtually unlimited authority."[2]

While the FTC chairman may feel that a self-regulated advertising industry may be more economical and equally effective, consumer groups feel that such policies could cause a reversion "back to the age of 'let the buyer beware,' or even 'let the buyer be milked.'"[3] A more positive view is held by Virginia Knauer, White House Consumer Affairs Advisor to President Reagan, who said, "I think this will be a golden opportunity for the business world to prove what they've been claiming for so long, that they can protect the consumer better than the federal government."[4]

In summarizing the global forces impacting on advertising regulation and the prospects for future regulation of advertising during the remainder of this decade, Boddewyn[5] sees continued heavy regulation of advertising. He cites a number of reasons for this belief:

Growth in services: More than two-thirds of the U.S. GNP comes from services, and this amount is continually increasing. Since services are usually less standardized than tangible goods, there is more opportunity for false and misleading advertising. Therefore more regulatory constraints will tend to result from the rise in the service economy.

Existence of vulnerable groups: Consumerists tend to argue that it is unfair to advertise to such vulnerable groups as children, the elderly, the ignorant, and the recently bereaved. Since an emotional case can be made on this point, there will continue to be calls made for additional regulation in this area.

New media technologies: As new media possibilities are developed—i.e., personal computers, videodisc players, subscription television, interactive cable, Viewdata and Teletext services, and direct satellite broadcasting—additional regulations will be needed to accommodate these developments.

**The authors are, respectively, Professor and Assistant Professor of Marketing, Texas A&M University, College Station, Texas.*

Environmentalism and conservationism: As people become more concerned about the environment and conserving its natural resources, such advertising methods as outdoor advertising (particularly illuminated signs/billboards) and unsolicited direct mail will come under pressure. Likewise, the advertising claims made for new energy-related and energy-saving products will come under increasing regulation.

Civil rights and privacy: There will continue to be calls for antidiscriminatory laws to protect against unfavorable ethnic or sexist portrayals in advertising. Likewise, the privacy intrusion of direct mail and telephone advertising will be a growing area of public concern.

Religion, morality, and taste: There is a return to more traditional and conservative beliefs and attitudes. There will be additional calls for regulation over advertising that is contrary to these beliefs and attitudes.

Recession and inflation: If slow economic growth continues, additional pressure will arise for more accurate and complete information in advertising so that consumers can be properly informed to receive value for their expenditures.

Because of these factors, Boddewyn sees the current deregulation movement as simply a regulatory pause, rather than a long-term dismantling of advertising regulations. He believes consumer protection will be the major rationale for regulation of advertising in the 1980s.

How do lawmakers feel about the future of advertising regulation? After all, it is *they* who make the final determination of whether additional regulation is necessary or whether existing regulation might even be curtailed. Although the chairmen of various regulatory agencies may desire cutting back their regulatory powers, it is Congress that has the final say so in these matters. For this reason, a study was made on the attitudes of U.S. Senators and Representatives in an effort to tap their feelings about future advertising regulation.

Methodology

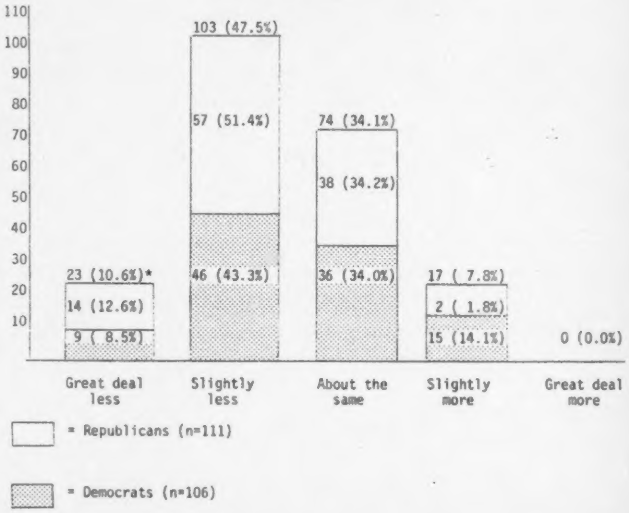
A short questionnaire was mailed to each member of the U.S. Senate and House of Representatives. After one follow-up mailing, a total of 36 Senators and 181 Representatives had responded, for a response rate of 40.5 percent.

The questionnaire consisted of only two questions. The first asked, "Do you feel there will be more or less federal regulation of advertising during the decade of the 1980s?" Congressmen were asked to check the appropriate blank on a five-point scale of "great deal more," "slightly more," "about the same," "slightly less," and "great deal less." Following this, the Congressmen were asked an open-ended question: "Would you state briefly why you feel this way?"

Results

The results of the survey show a definite feeling among U.S. Congressmen toward deregulation of advertising. As shown in Figure 1, none of the 217 lawmakers feel there will be a great deal more regulation of advertising, and only 17 (or 7.8 percent) feel there will be slightly more. As indicated in the breakdowns by party affiliation in the figure, those believing that there will be slightly more regulation of advertising consisted of 15 Democrats (14.1 percent of the Democrats sampled) and only 2 Republicans (1.8 percent of the Republicans sampled). The major reason cited by these Congressmen for anticipating more advertising regulation is the continued deceptiveness in advertising and its impact on the consumer's pocketbook. For example, one of the two Republicans expecting more regulation of advertising said, "There is increasing concern among our citizens for accuracy in media presentations, generally, and particularly about the things that people buy with dollars hard earned during a period of economic difficulty."

Figure 1
OVERALL VIEWS OF U.S. LEGISLATORS ON THE EXTENT OF FEDERAL REGULATION OF ADVERTISING DURING THE 1980s
(n=217)



*To be read: "10.6 percent of all U.S. legislators surveyed (12.6 percent of the Republican legislators surveyed and 8.5 percent of the Democratic legislators surveyed) believe there will be a great deal less federal regulation of advertising during the 1980s."

This attitude, however, was definitely in the minority in Congress. A total of 74 (34.1 percent) of the lawmakers anticipate advertising regulation to continue at about the same level, 103 (47.5 percent) believe it will be slightly less, and 23 (10.6 percent) feel there will be a great deal less federal regulation of advertising. Most of the 58.0 percent who believe there will be less regulation of advertising in the remainder of the decade say there is a national mood toward less government, in general, that has been spawned by President Reagan. A northern Democratic representative noted this general mood is currently being "accented by the present Reagan administration with broad support throughout our country." Likewise, a southern Democratic representative

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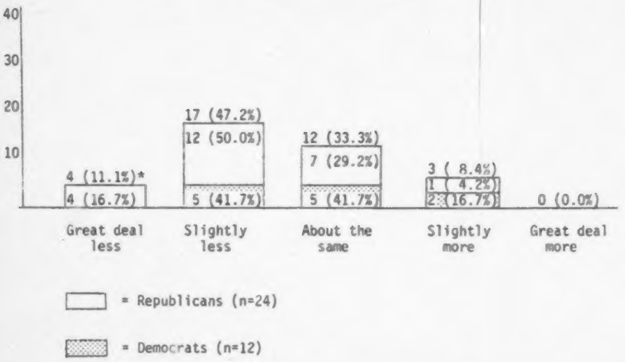
summarized this mood toward less advertising regulation by noting that the "time has come to get government off everyone's back including advertisers."

In general, Republicans tend to be more optimistic about deregulating advertising than do Democrats. A total of 71 (64.0 percent) of the Republican Congressmen feel there will be less regulation of advertising, while only 55 (51.8 percent) of the Democratic Congressmen feel this way.

Figures 2 and 3 show the results when the two houses of Congress are analyzed separately. Approximately 58.0 percent of each say there will be less regulation of advertising in the future, and approximately 8.0 percent of each say there will be more. In the Senate, however, there is a notable difference in party viewpoints. Among Senators, many more Republicans (a total of 16, or 66.7 percent) than Democrats (a total of 5, or 41.7 percent) anticipate less advertising regulation.

Figure 2
U.S. SENATORS' VIEWS
ON THE EXTENT OF FEDERAL
REGULATION OF ADVERTISING
DURING THE 1980s
(n=36)



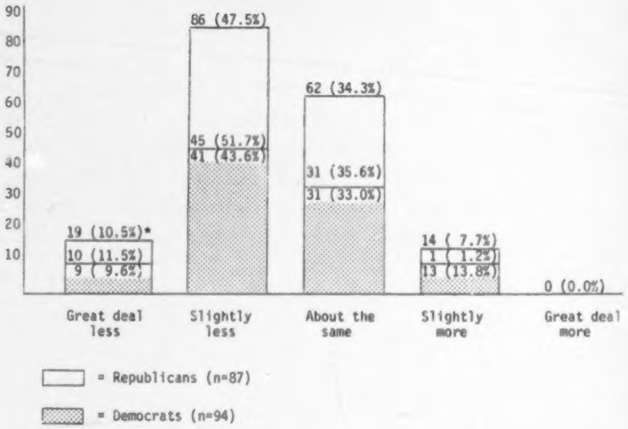
*To be read: "11.1 percent of all U.S. Senators surveyed (16.7 percent of the Republican Senators and none of the Democratic Senators) believe there will be a great deal less federal regulation of advertising during the 1980s."

Several other viewpoints about advertising regulation emerged from an analysis of the answers to the open-ended question. Thirty (13.8 percent) of the lawmakers noted that future advertising regulation will need to adjust to new technology in communication such as cable television. A Democratic Congressman from the Southeast stated that such innovations "will require a new approach to advertising regulation—not additional regulation."

Of those legislators believing there will be less advertising regulation in the remainder of the 1980s, 16 (12.7 percent) qualified their views by noting that the pendulum is likely to swing to more regulation in the 1990s. For example, a southern Democrat warned, "Look for a strong backlash in the latter part of the century."

Thirteen (10.3 percent) of the legislators expecting less advertising regulation in the remainder of the decade believe that less regulation is needed because of the increased sophistication of the consumer. For example, a Republican Congressman from the Southeast said that consumers "are intelligent enough to shop wisely with less help from the federal government."

Figure 3
U.S. REPRESENTATIVES' VIEWS
ON THE EXTENT OF FEDERAL
REGULATION OF ADVERTISING
DURING THE 1980s
(n=181)



*To be read: "10.5 percent of all U.S. Representatives surveyed (11.5 percent of the Republican Representatives and 9.1 percent of the Democratic Representatives) believe there will be a great deal less federal regulation of advertising during the 1980s."

The 34.1 percent of the lawmakers who feel that advertising regulation will remain about the same generally gave either one of two reasons: (1) any attempts to significantly increase regulation of advertising would border on violation of the First Amendment; and (2) any attempts to reduce regulation would be met by strong criticisms from consumerist groups.

Conclusions and Implications

The results of this survey of U.S. Senators and Representatives clearly suggest that the deregulation emphasis by President Reagan will also be carried over into advertising. It can be expected that advertising regulation will, most likely, be reduced during the remainder of the 1980s. One should be aware, however, that this study only reflects the attitudes of the *present* Congress at the *present* time. Also, these Senators and Representatives, who are elected by the people, tend to vote the way they perceive their constituents want them to vote. So, as the make-up of Congress changes and people's attitudes change, the feeling in Congress toward advertising regulation may also change. At the present time, however, there is definite congressional sentiment to reduce federal regulation of advertising.

What does this mean for advertisers? Very simply, it means that advertising will require more self-regulation by the advertisers themselves. And the feeling among the federal lawmakers is that the burden is now on advertisers to demonstrate that they can regulate themselves and give consumers adequate and accurate information for the

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products they buy. It appears that Congressmen are willing to give advertisers more freedom to operate, but advertisers must make sure both hands are kept above the table or they may wind up being tied even tighter in the future.

So, one might say, the choice is really up to the advertisers themselves as to whether the future will bring more or less federal government regulation over advertising. There are many factors in the environment that tend to indicate a need for more or continued advertising regulation in the future.[6] But federal lawmakers seem to be willing to exercise some faith in allowing advertisers to regulate themselves. It is now up to advertisers to live up to this congressional vote of confidence and exercise a high degree of quality control over the adequacy and accuracy of every advertisement.

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[1] Kenneth Chilton, *A Decade of Rapid Growth in Federal Regulation* (St. Louis: Washington University Center for the Study of American Business, 1979).

[2] James Miller III, *Advertising Age*, March 15, 1982.

[3] Lucia Mouat, "As Critics Worry About New FTC Head and Marketing Regulation," *The Christian Science Monitor*, March 17, 1982.

[4] Karen DeWitt, "Reagan's Consumer Chief Notes Policy Shift," *New York Times*, April 4, 1981, p. 21.

[5] J.J. Boddewyn, "Advertising Regulation in the 1980s: The Underlying Global Forces," *Journal of Marketing*, Winter 1982, pp. 27-35.

[6] Ibid.

COMMERCIAL BANKING TRENDS IN THE SOUTHEAST

*Michele A. Burns**

There have been fundamental changes in commercial banking in the United States over the past two decades. The events that began in the mid-1960s are particularly relevant for projecting banking trends in the 1980s. The breakdown of product market segmentation, the volatile cost of purchased funds, and the tight money policy of 1974 forced commercial banks to perform in markets more highly competitive than ever before. During the 1970s, the U.S. economy experienced almost two complete interest rate cycles. The first cycle is identified with falling rates in 1970-1971 and rising rates in 1972-1973-1974. The second cycle is identified with falling rates in 1975-1976 and rising rates in 1977-1978-1979.[1] With interest rates reaching historically high levels and the failures of several national banks, the 1970s became a period when the financial stability of the banking system was a matter of concern to regulatory authorities and investors alike.

The purpose of this article is to analyze the operating characteristics and profitability of insured commercial banks in the Sixth Federal Reserve District from 1964 through 1981.[2] The Sixth District comprises Florida, Georgia, Alabama, western Tennessee, southern Mississippi, and southern Louisiana.

This study examines the changing composition of bank sources and uses of funds, revenues, and expenses, and the factors that have had the most significant impact on bank profitability. Annual balance sheet and income statement data are utilized to derive a variety of financial ratios that are designed to measure bank operations and performance by examining the composition of assets and liabilities, liquidity, capital adequacy, the composition of revenues and expenses, efficiency, and profitability. The ratios selected for use in this analysis are defined in the Appendix. Mean ratios are computed from aggregate dollar figures. The ratios selected for the profitability analysis are those that have been meaningful in previous banking studies.[3] The mean values of the ratios are computed annually to serve as a measure of the "average" or mean bank for the district.

Basically, the individual bank has little control over the level of interest expense, since rates are determined by competitive markets. However, management can decide how to use its personnel, the composition of credit and of security investments, and the volume of purchased funds. Many of the variables examined in this study are, in essence, proxies for the managerial ability of the sample banks. While the variables do not directly measure managerial ability, they do reflect the consequences of management decisions.

Many of the changes that have occurred in the banking industry over recent years can be expected to continue in the 1980s. The study reveals several significant changes in the structure and operations of the banks in this sample during the 1964 through 1981 period. First, there were major changes in the banks' sources of funds. Second, the banks experienced significant growth in operating expenses relative to operating earnings as well as major changes in the components of total expenses. Third, the banks experienced rising profitability over the 1964 through 1970 portion of the period and a significant reversal of that trend from 1971 through 1976. However, the relative improvement in bank profitability beginning in 1977 may indicate a new trend in performance in the eighties, as bank managers adjust to the changing banking environment.

Banking Structure

Table 1 illustrates the net increases in the number of banks in the United States and the Sixth District during the period. As a percentage of banks in the United States, the Sixth District banks grew from 11.69 percent in 1969 to 12.28 percent in 1980. Banks in the Sixth District increased by 14.0 percent from 1969 to 1980 compared to an increase of 8.6 percent in total U.S. banks over the same period.

Table 1

COMMERCIAL BANKS IN THE UNITED STATES AND THE SIXTH FEDERAL RESERVE DISTRICT

Year	United States	Sixth District Number	Sixth District Percent of U.S.
1969	13,662	1,598	11.69
1970	13,688	1,642	11.99
1971	13,786	1,684	12.21
1972	13,930	1,735	12.45
1973	14,174	1,827	12.88
1974	14,459	1,935	13.38
1975	14,631	1,985	13.56
1976	14,672	2,001	13.63
1977	14,704	1,931	13.13
1978	14,712	1,873	12.73
1979	14,708	1,845	12.54
1980	14,836	1,823	12.28

Source: Federal Reserve Bulletin, February 1982.

Table 2 shows total assets, total deposits, and total capital for all Sixth District banks annually. There was a gradual increase in assets in each year of the period. Total assets of $144 billion in 1981 reflect a 616.0 percent increase from the 1964 level. The compound growth rate for the period was 11.3 percent.

Assistant Professor of Finance, University of New Orleans, Lake Front, New Orleans, Louisiana.

Table 2

TOTAL ASSETS, DEPOSITS, AND CAPITAL
OF INSURED COMMERCIAL BANKS
IN THE SIXTH DISTRICT
($ Thousands)

Year	Total Assets	Total Deposits	Total Capital
1964	$ 23,457,272	$ 20,914,504	$ 1,883,618
1965	26,326,722	23,470,095	2,053,484
1966	28,722,464	25,471,080	2,240,352
1967	32,190,307	28,623,612	2,478,653
1968	36,619,794	32,379,219	2,709,864
1969	39,404,235	33,997,974	3,034,126
1970	44,043,596	38,075,081	3,426,591
1971	50,921,685	43,991,233	3,819,126
1972	61,237,814	52,621,653	4,409,122
1973	71,551,715	60,017,577	5,223,275
1974	77,557,006	64,837,657	5,816,775
1975	81,221,300	68,258,382	6,254,040
1976	86,211,404	73,874,552	6,896,912
1977	96,848,977	83,086,737	7,457,370
1978	107,770,509	91,367,837	8,244,443
1979	118,690,399	100,269,649	9,222,243
1980	130,914,151	109,562,053	10,054,206
1981	144,640,380	119,430,221	11,007,132

Source: FDIC call reports.

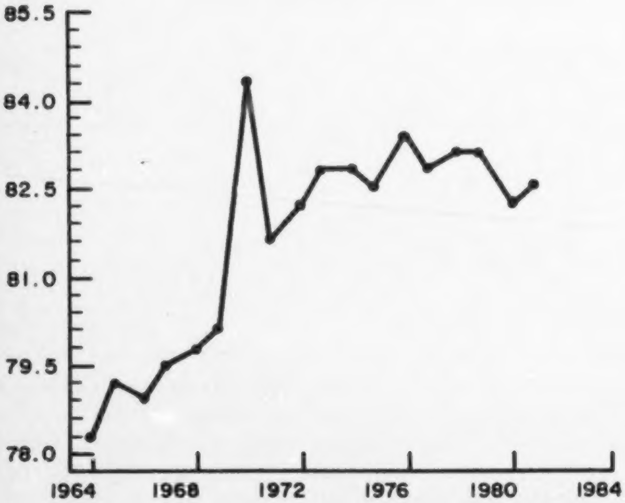
There was also a gradual increase in total deposits in every year of the period. Total deposits of $119 billion in 1981 reflect a 571.0 percent increase from the 1964 level. The compound growth rate for deposits of 10.8 percent is less than the growth rate for assets during the period.

Capital increased annually during the period from $1.8 billion in 1964 to $11 billion in 1981, a 584.0 percent increase. The compound growth rate for bank capital was 10.8 percent compared to the 11.3 percent growth rate for assets. Banks in the Sixth District increased their assets at a rate faster than the increase in capital during the period, indicating a growing use of financial leverage.

Sources and Uses of Funds

The growth of earning assets as a percentage of total assets for the average bank is illustrated in Figure 1. The ratio was at its lowest level in 1964, at 78.38 percent, and increased gradually over the period. The 82.4 percent ratio in 1981 is slightly below the 83.0 percent levels in 1978 and 1979.

FIGURE 1
EARNING ASSETS AS PERCENTAGE OF TOTAL ASSETS



The proportion of loans and securities to total assets shows a gradual increase in loans as a percentage of assets, from approximately 45.0 percent to slightly better than 51.0 percent. The proportion of assets invested in securities shows a decreasing trend over the period, averaging slightly better than 26.0 percent in 1981.[4]

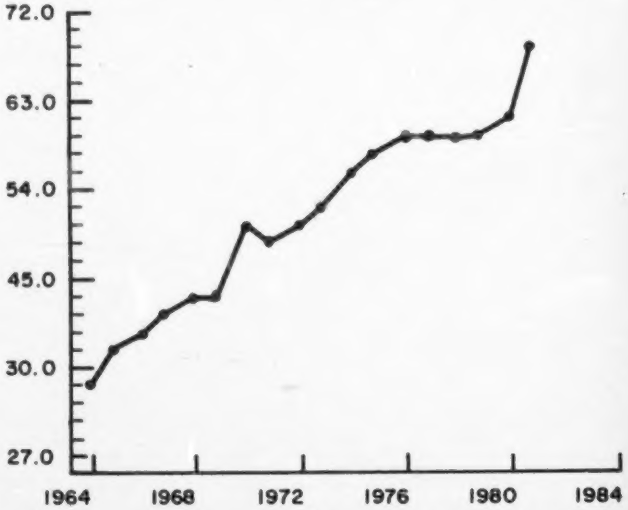
An examination of the loan portfolio of the mean bank shows a shift in the proportions among the three categories of loans through the period. The proportion of real estate loans increased from 22.0 percent to 34.0 percent, while the proportion of business loans declined from 32.0 percent to 27.0 percent. The proportion of consumer loans averaged 30.0 percent to 34.0 percent through the period and was at 30.0 percent in 1981.

Examination of the securities portfolio shows that the banks experienced a rapid decline in their holdings of Treasury securities during the period. From 67.0 percent in 1964, the proportion of Treasury securities to total securities fell to 25.0 percent in 1974. In the same year, holdings of municipals reached a period high of 56.0 percent of the securities portfolio. There was a slight reversal of the trend after 1975, and in 1981 Treasury securities were 31.0 percent and municipals were 44.0 percent of the securities portfolio. Securities of federal agencies represented a period high of 22.0 percent of the securities portfolio.

The percentage of total deposits to total liabilities fell to its lowest level of the period in 1981, at 89.0 percent. The ratio was 97.0 percent in 1964. At the same time, federal funds purchased to total liabilities reached a period high in 1981 of 7.0 percent.

The Sixth District banks experienced a significant shift in the proportions of time and savings deposits and demand deposits. As Figure 2 illustrates, there was a consistent increase in the ratio of time and savings

FIGURE 2
TIME DEPOSITS AS PERCENTAGE OF TOTAL DEPOSITS



deposits to total deposits, reaching an all-time high of 68.0 percent in 1981.

The capital to asset ratio of 7.6 percent in 1981 reflects the average for the period. The ratio was lowest in 1972, at 7.2 percent, and highest in 1970, at 8.7 percent. The ratio was relatively stable throughout the period, declining only slightly in the latter years. A more noticeable decline occurred in both the capital to risk assets[5] ratio and the capital to loans ratio. Capital to risk assets was 13.0 percent in 1964 and 9.0 percent in 1981, while capital to loans was 17.0 percent in 1964 and 14.0 percent in 1981. Both ratios showed a declining trend throughout the period.

The percentage distribution of assets, liabilities, and capital for 1964 and 1981 is presented in Table 3.

Table 3

BALANCE SHEET DISTRIBUTIONS
(In Percentages)

	1964	1981
Assets		
Cash and due from banks	19.4	13.6
Treasury and agency securities	21.6	14.2
Other securities[1]	10.5	18.5
Loans	46.2	51.1
Other assets	2.3	2.6
Total Assets	100.0	100.0
Liabilities and Capital		
Demand deposits	57.7	26.8
Time and savings deposits	31.5	55.9
Borrowings[2]	1.3	7.3
Other liabilities	1.5	1.8
Capital accounts	8.0	8.2
Total liabilities and capital	100.0	100.0

[1] Includes federal funds sold.

[2] Includes federal funds purchased and other liabilities borrowed.

Source: FDIC annual call reports.

Revenues and Expenses

Annual operating income for the Sixth District banks grew at a compound rate of 11.7 percent over the period. Growth was relatively more rapid in the last years of the period, as illustrated in Figure 3. Operating income grew at a 23.0 percent rate from year-end 1977 to 1981.[6]

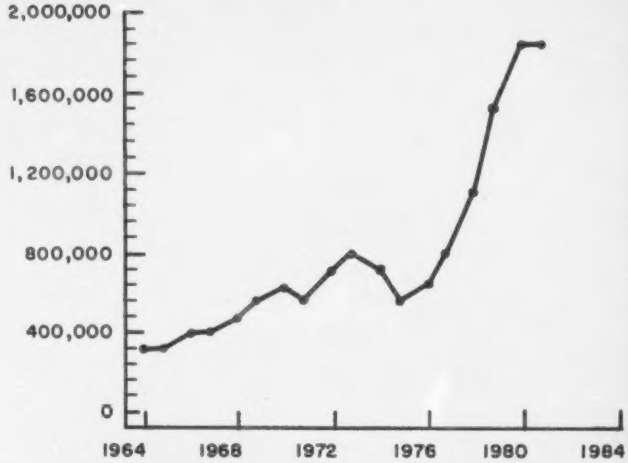
The proportion of total revenues generated by loan revenues was 60.0 percent in 1981, reflecting the proportion for most years throughout the period. Loan revenues were at the lowest percentage in 1970, at 56.0 percent of total revenues, and at the highest percentage in 1974, at 65.0 percent of total revenues.

The ratio of interest and fees to total loans increased significantly over the period. The ratio ranged from 5.0 percent in the mid-1960s to 9.0 percent in the mid-1970s, and was 12.0 percent in 1980 and 13.0 percent in 1981.

The ratio of interest on security investments to total revenues was at 25.0 percent in 1981, slightly higher than in the previous three years. The ratio was at a low in 1974, at 17.0 percent, and at a high in 1970, at 28.0 percent, and again in 1976 and 1977, at 27.0 percent.

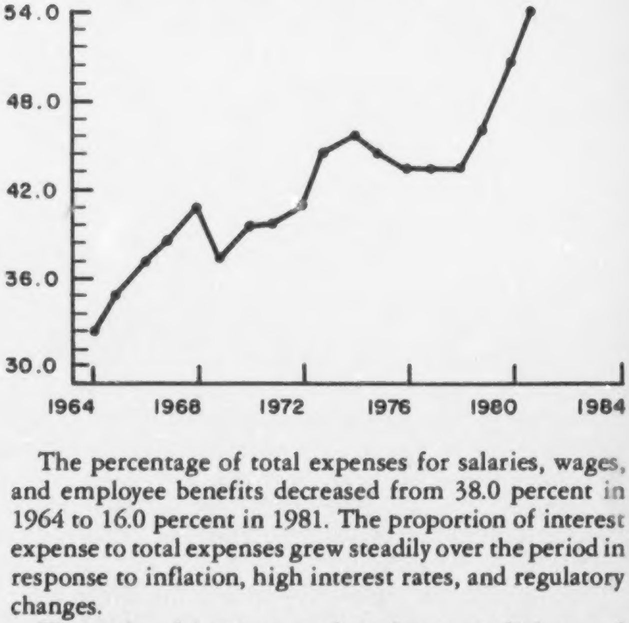
A third component of total revenue, service charges, experienced a gradual decline throughout the period. In 1964, service charges as a percentage of total revenues was 7.0 percent and in 1981 the ratio was 3.0 percent.

FIGURE 3
OPERATING INCOME



Cost of funds is the major expense item for commercial banks. There was significant shift in the components of total expenses during the period. As Figure 4 illustrates, interest on deposits as a percentage of total expenses increased from 31.0 percent in 1964 to 54.0 percent in 1981.

FIGURE 4
INTEREST EXPENSE AS PERCENTAGE OF TOTAL EXPENSES



The percentage of total expenses for salaries, wages, and employee benefits decreased from 38.0 percent in 1964 to 16.0 percent in 1981. The proportion of interest expense to total expenses grew steadily over the period in response to inflation, high interest rates, and regulatory changes.

The ratio of interest on deposits to total time and savings deposits increased gradually from approximately 3.0 percent in 1964 to 5.0 percent in 1977, and was 10.0 percent in 1981. As noted previously, the ratio of interest and fees on loans also increased during the period, from approximately 5.0 percent in 1964 to 8.0 percent in 1977 and 13.0 percent in 1981. The spread between the two ratios did not increase over the period.

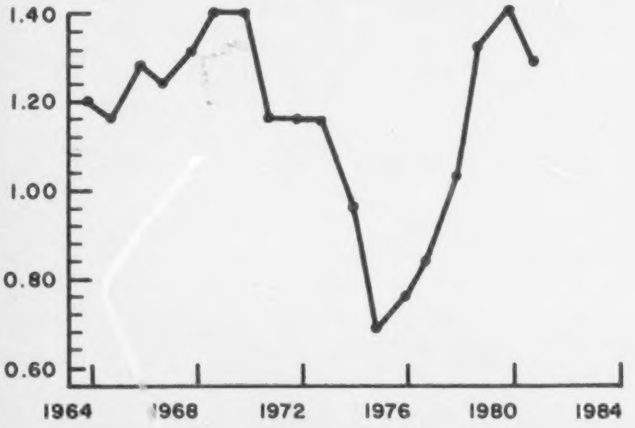
The ratio of net loss on assets to net income exhibits a dramatic change in the second half of the period. From 1967 through 1971, the ratio fluctuated between 15.0 percent and 25.0 percent for the Sixth District. In 1972 and 1973, the ratio fell to a range of approximately 13.0 percent to 18.0 percent. From 1974 through 1976, the ratio experienced a dramatic increase, rising to 91.0 percent for the Sixth District in 1976. There appears to be a reversal of the trend in 1977. The ratio declined to 67.0 percent in 1977 and was 25.0 percent in 1981.

Profitability

The measures used to evaluate profitability are (1) return on assets, (2) return on capital, (3) productivity, and (4) profit margin.

Examining the trend in annual return on assets reveals that the Sixth District banks achieved the highest returns, 1.38 percent, in 1969 and 1970 and, again, in 1980. The return for 1981 declined to 1.28 percent. The lowest levels of return for the period were in the years from 1974 through 1977, all below 1.0 percent. After 1977 return on assets increased each year until 1981, as illustrated in Figure 5.

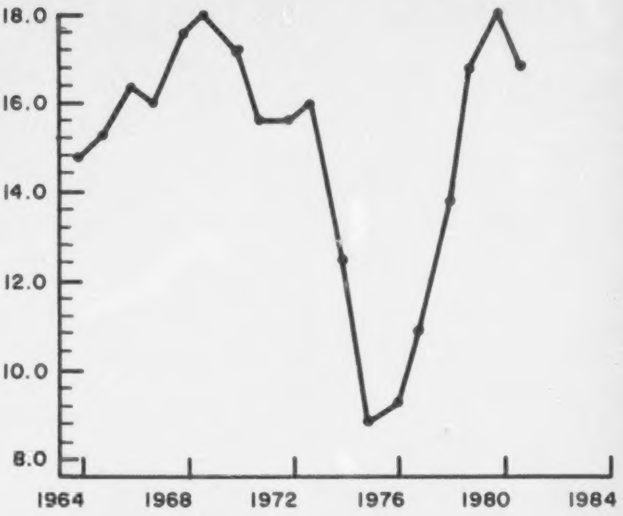
FIGURE 5
OPERATING INCOME AS PERCENTAGE OF ASSETS



Return on capital averaged between 13.0 percent and 15.0 percent from 1964 through 1971. In 1974, return on capital for the Sixth District mean bank fell to 12.5 percent from 16.0 percent in 1973. The trend was down from 1975 through 1976. In 1975, the Sixth District mean bank achieved a period low return of 8.5 percent, as illustrated in Figure 6.

After the low returns achieved in 1975 and 1976, the average return on capital grew very rapidly, reaching the highs of the earlier years of the period. The return on capital for the Sixth District mean bank in 1981 was 16.8 percent, down from the 1980 return of 17.9 percent.

FIGURE 6
OPERATING INCOME AS PERCENTAGE OF CAPITAL



Return on assets is a function of productivity of assets and profit margin.[7] Return on capital is also a function of these two variables, as well as the ratio of capital to assets. Table 4 presents average annual profitability rates and measures of productivity and profit margin for the total period and for two selected subperiods. For the total period, Sixth District banks achieved an average return on capital of 14.9 percent and an average return on assets of 1.1 percent. Both measures of profitability were higher in the 1964-1970 subperiod compared to the 1971-1981 subperiod.

Table 4

AVERAGE ANNUAL PROFITABILITY MEASURES
(In Percentages)

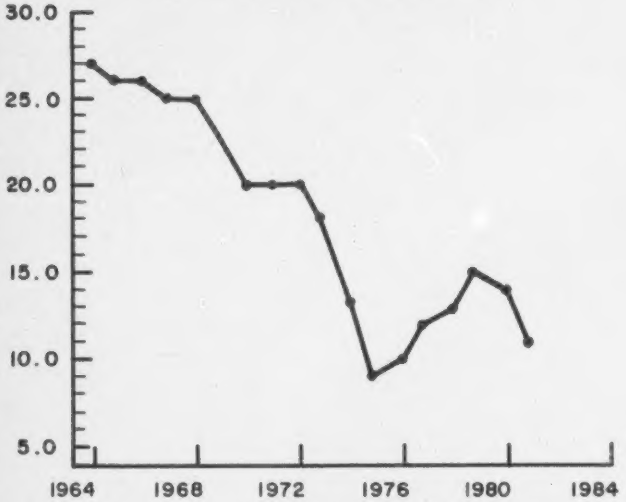
Variables	1964-81	1964-70	1971-81
Operating Income Total capital	14.9	16.4	13.9
Operating Income Total assets	1.1	1.3	1.0
Total Revenue Total earning assets	8.2	6.4	9.4
Operating Income Total revenue	18.0	24.5	13.9

There was a significant change in the two components of return on assets during the period. The turnover of assets, productivity, was higher in the later years, averaging 9.4 times, compared to an average turnover of 6.4 times in the first part of the period. Profit margins were significantly declining as productivity improved. The average profit margin of 13.9 percent in the 1971-1981 subperiod was almost half of the average profit margin of 25.5 percent in the 1964-1970 subperiod.

These measures indicate that the banks were attempting to offset declining profit margins with increased productivity of assets. However, as the profitability rates in Table 4 indicate, on average the banks were not successful enough in this strategy to stop average profitability from declining during the 1971-1981 period from the 1964-1970 levels.

Figure 7 illustrates the rapid decline in profit margin throughout the period. Average profit margin fell to its lowest level in 1975, at 9.4 percent. From 1976 to 1979, profit margin gradually improved, but it fell in 1980 and again in 1981, when it was at 10.8 percent. This margin was below the level achieved in every year of the period except 1975 and 1976.

FIGURE 7
PROFIT MARGIN: OPERATING INCOME AS PERCENTAGE OF TOTAL REVENUE



However, as profit margins were falling, productivity levels were significantly improved. Productivity was lowest in 1964 and 1965, at 5.6 times, and increased steadily to 10.7 times in 1979. In 1980, productivity jumped to 12.2 times and in 1981 it jumped again to 14.3 times.

Productivity and profit margins determine the return on assets. Given the return on assets, one method of improving the return on capital is to increase the use of financial leverage, thus lowering the ratio of capital to assets. Banks in the Sixth District did not significantly increase their use of financial leverage. As noted previously, the capital to asset ratio was relatively stable throughout the period. The ratio averaged 7.8 percent from 1964 through 1970 and 7.6 percent from 1971 through 1981.

In addition to productivity, profit margin, and financial leverage, the major variables that impact on return on capital include (1) the level of earning assets, (2) the ratio of loans to assets and the yield on the loan portfolio, and (3) the percentage of interest-bearing deposits to total deposits.

The relative improvement in profitability rates from 1978 through 1981 may be partially explained by examination of these variables. The level of earning assets, the ratio of loans to assets, and the yield on the loan portfolio all increased steadily throughout the period. The yield on the loan portfolio increased significantly, from 5.0 percent in 1965 to 13.0 percent in 1981.

However, the Sixth District banks did experience significantly lower rates of profitability in the 1970s and early 1980s, compared to the 1960s. This is substantially explained by the changes in the mix of deposit sources of funds and the rising cost of interest-bearing deposits. Time and savings deposits increased from 35.0 percent to 67.0 percent of deposit funds. At the same time, the ratio of interest on deposits to total interest-bearing deposits increased from 3.0 percent to 10.0 percent.

Conclusion

There were fundamental changes in the financial characteristics of banks operating in the Sixth Federal Reserve District during the period from 1964 through 1981. There was a major shift in the mix of bank deposits from demand deposits to interest-bearing deposits. Banks reduced their liquidity by increasing the level of earning assets, primarily the investment in loans. Although the yield on loans increased, profit margins were squeezed by the rapidly increasing cost of funds.

Interest expense grew to exceed employee expenses as the major component of total expenses. This led to several years of declining profitability from 1971 through 1977. Increases in the productivity of assets, particularly in the last few years of the period, indicate attempts by the banks to offset declining profit margins. Whether the relative improvement in profitability beginning in 1978 will continue depends on the bank managers' ability to respond quickly and competitively to the changing bank environment.

Appendix

FINANCIAL RATIOS FOR ANALYSIS OF OPERATING CHARACTERISTICS OF COMMERCIAL BANKS

Composition of Assets

Loans/total assets
  Business loans/total loans
  Consumer loans/total loans
  Real estate loans/total loans
Securities/total assets
  Treasury securities/total securities
  State and subdivision obligations/total securities
  Federal agency securities/total securities
Earning assets/total assets

Composition of Liabilities

Total deposits/total liabilities
Demand deposits/total deposits
Federal funds purchased/total liabilities

Capital Adequacy

Total capital/total assets
Total capital/total risk assets
Total capital/total deposits

Composition of Revenues

Loan revenue/total revenue
Interest on investments/total revenue

Service charge/total revenue
Interest and fees on loans/total loans

Composition of Expenses
Salary, wages, and employee benefits/total expenses
Interest on deposits and other money/total expenses
Interest on deposits/total time and savings deposits
Net loss on assets/net income

Profitability
Operating income/total assets
Operating income/total capital
Operating income/total revenue
Total revenue/total earnings assets

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[1] Ronald L. Olson, Donald G. Simonson, Stanley R. Reber, and George H. Hempel, "Management of Bank Interest Margins in the 1980's," *The Magazine of Bank Administration*, March 1980, pp. 1-11.

[2] Data were obtained from the Federal Deposit Insurance Corporation annual call reports.

[3] William F. Ford, "Profitability: Why Do Some Banks Perform Better Than Averge? An In-Depth Analysis," *Banking*, October 1974, pp. 29-32 and 54; John A. Haslem, "A Statistical Estimation of Commercial Bank Profitability," *Journal of Business* 42 (January 1969): 22-35; and Paul A. Meyer and Howard W. Pifer, "Prediction of Bank Failure," *Journal of Finance*, September 1970, pp. 853-68.

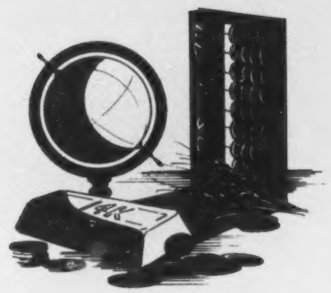
[4] For all insured commercial banks in 1981, the ratio of earning assets to total assets was 80.8 percent, the ratio of loans to assets was 54.5 percent, and the ratio of securities to assets was 20.0 percent (Barbara N. Opper, "Profitability of Insured Commerical Banks," *Federal Reserve Bulletin*, August 1982, pp. 453-65).

[5] Risk assets are defined as total assets minus cash and U.S. Government Treasury securities.

[6] Earnings for the banking industry as a whole have improved annually over the last 20 years to the extent that earnings growth outpaced inflation (William F. Ford, "Banking's New Competition: Myths and Realities," Federal Reserve Bank of Atlanta *Economic Review*, January 1982, pp. 4-11).

[7] Productivity is measured as total revenue divided by total earning assets. Profit margin is measured as operating income divided by total revenue.

TAX CORNER



by Wm. Brent Carper, Ph.D., C.P.A.

TEFRA CHANGES RETIREMENT RULES

The 1982 Tax Equity and Fiscal Responsibility Act (TEFRA) makes significant changes for both corporate and self-employed retirement plans. In short, the new law curbs the contribution and benefit limitations for corporate plans while effecting parity between corporate and self-employed plans (HR-10 or Keogh plans).

Corporate Plans

When the Employee Retirement and Income Security Act (ERISA) was enacted in 1974, the maximum annual pension benefit for defined benefit plans was limited to the lesser of 100.0 percent of the three-year consecutive highest pay or $75,000 per employee, adjusted for cost-of-living increases. As a result of these increases, the $75,000 limit for 1982 was $136,425.

TEFRA reduces the maximum on employer-derived annual benefits under defined benefit plans for plan years beginning in 1983. The limit per employee is decreased from $136,425 to $90,000. The 100.0 percent of compensation limit is not changed.

Correspondingly, the maximum contribution to a profit-sharing plan or defined contribution plan was the lesser of 25.0 percent of annual compensation or $25,000 per employee as adjusted. Due to the cost-of-living adjustments, the dollar limitation for 1982 was $45,475.

The new Act reduces the maximum dollar limit on annual additions for an employee under defined contribution plans of an employer. The amount is decreased from $45,475 to $30,000. The overall 25.0 percent contribution limitation for all employees remains unchanged.

The new limits remain in effect until 1986. Beginning in 1986, the limits will be adjusted for post-1984 cost-of-living increases, measured by the formula then in effect to provide cost-of-living increases in Social Security benefits. Beginning in 1986, the new cost-of-living adjustments also will apply to self-employed plans, Subchapter S corporations (now called S Corporations), and simplified employee pension plans (SEPs).

As for employees who participate in both defined benefit and defined contribution plans offered by the same employer, the aggregate limit applied with respect to both types of plans is reduced. Under the Act, the sum of the defined benefit's fraction and the defined contribution's fraction cannot exceed 1.25 as applied only to dollar limits. That is, the DBP contribution divided by $90,000 plus the DCP contribution divided by $30,000 cannot exceed the 1.25 limit. Under prior law, the limit was 1.40.

Self-Employed Plans

Historically, self-employed plans for sole-proprietorships and partnerships have had lower limits than corporate or qualified retirement plans (QRPs). Prior to TEFRA, the deductible contribution to an HR-10 or Keogh plan was the lesser of 15.0 percent of earned income or $15,000 for each participant. Beginning with 1983 plan years, the limit is increased to $30,000 for each employee with the same cost-of-living adjustments as those planned for corporate QRPs.

Most HR-10 plans are defined contribution plans. Under prior law, defined benefit HR-10 plans were acceptable, but such plans were rarely used because of their complexity and special funding limitations. The new law removes many of the obstacles for defined benefit HR-10 plans, and applies the regular dollar and percentage limitations now applicable to similar corporate plans. In essence, Congress has removed the inequity between corporate and self-employed plans for plan years beginning after 1983.

Loans to Participants

Under the new law, both corporate and self-employed plans are able to permit loans to participants at reasonable interest rates with proper security. Prior law only permitted QRPs to make such loans.

TEFRA now allows a plan participant to borrow up to one-half of his vested benefits not to exceed $50,000. However, a participant may borrow up to $10,000 regardless of his/her level of vested benefits. The loan term cannot exceed five years unless the loan proceeds are used to acquire or substantially renovate the participant's or a family member's principal residence. The new loan limits apply to loans made after August 13, 1982.

There is a transitional rule for existing loans in excess of the new limits that are due after August 13, 1982. Such loans may be refinanced through the plan, provided that repayment of the total amount due is made by August 13, 1983. Thus, plan participants have until August 13, 1983 to arrange alternative financing for existing loans.

The new limits apply to the participant's cumulative loan balance, including loans entered into prior to August 13, 1982. Pre-TEFRA loans, however, are not affected by the five-year repayment rule.

"Top-Heavy" Plans

New restrictions apply to both corporate and noncorporate plans that are "top-heavy." These are plans where more than 60.0 percent of the benefits or the account balances are paid to "key employees." Individuals are defined as "key-employees" if (during the plan year or four preceding plan years) they were:

1. Over one percent owners earning more than $150,000 (dollar limit indexed beginning in 1986);
2. Over five percent owners;
3. Officers (the greater of three or ten percent of the employees, but not to exceed 50 percent);
4. Among the top ten employees with the largest ownership interest in the employer.

If a plan is top-heavy, certain restrictions apply. These restrictions include faster vesting requirements, special compensation limits regarding determination of benefits, minimum nonintegrated benefits for nonkey employees, special rules for computing aggregate benefits from both pension and profit-sharing plans, and an additional ten percent income tax on distributions to key employees prior to age 59 1/2. In any case, payments must commence no later than the year in which a key employee reaches age 70 1/2 regardless of whether he/she continues to work. The rules cannot be avoided through the use of one-person corporations or "leasing employees" from another firm.

Other Provisions

Under the new Act, partial rollovers of Income Retirement Account (IRA) distributions are nontaxable if completed within 60 days of the receipt of the distribution. Any remaining amount is taxed in the year of receipt as ordinary income and also is subject to the special ten percent penalty tax. The Act applies to distributions made after December 31, 1982.

The estate tax exclusion, under the new law, is limited to an aggregate limit of $100,000. The limit applies to certain retirement benefits paid under qualified pension plans, tax-sheltered annuities, individual retirement accounts, and certain military retirement plans. The new limits apply with respect to decedents dying after December 31, 1982.

Conclusion

The foregoing represents a brief overview of the significant tax changes for retirement plans brought about by the 1982 Tax Equity and Fiscal Responsibility Act. The reader is advised to consult a competent tax advisor should he/she have specific questions regarding the subject. The topic can be extremely complex.

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LOCAL RESTRICTIONS ON MINORITY AND LOW-INCOME HOUSING DEVELOPMENT: REDLINING, ZONING, AND SITING OF SUBSIDIZED HOUSING

*Richard Evans and Edward Hoskins**

One explanation for housing discrimination against blacks and low-income households is that it is an exercise in market power. Racial segregation and market power may allow market segmentation, then profitable racial price discrimination against black and low-income households. This argument appears as fact in an early 1970s Chicago area case.[1] The Seventh Circuit Court of Appeals decision agrees that racially separate markets for newly constructed houses existed in the area, that demand for black-area houses exceeded supply, and that prices there were higher than for comparable houses in white areas. The court used the 1866 Civil Rights Act to rule that the builder had unlawfully exploited the situation to charge higher prices to blacks, perpetuating the discrimination without having any racial motivations.

While racial prejudice is not a necessary assumption for this explanation of discrimination, cartel or monopoly power is necessary for successful, privately-organized price discrimination against black or low-income households. In considering this possibility, the economist would have to doubt that private market power is sufficient in most urban housing markets to allow the development of profitable discrimination. Monopoly is very rare in housing markets, existing only in histories of "company towns." Few cities have anything except a markedly atomistic housing market. A classic cartel would have to be run by managers with unheard of data collection powers, keeping tabs on thousands of sellers who have great motivation to trade with blacks on profitable terms despite quotas set by the cartel. How would quotas be stated (when most sellers will sell zero or one unit); how will discipline be imposed?

In all, it seems impossible for privately-generated market power to exist in U.S. housing markets. A different conspiracy scenario seems more likely in the market for housing. In an effort to curry business, social, and political alliances with high-income groups, local housing authorities may publicly cartelize and segment a market that could not be organized privately. In times not long past zoning authorities racially segmented the housing market with "white" and "colored zones." Zoning by house and lot size and other cost-related housing attributes, still common today, segments the housing market by income group. Also common today are public housing authorities selecting the sites for low-income housing projects. The policies adopted by public housing authorities may maintain existing racial and income patterns, hasten the racial polarization of neighborhoods in racial transition, or integrate the city in terms of both race and income. Both zoning authorities and public housing authorities may be instruments of housing market segmentation, whether or not a conspiratorial alliance with high-income groups can be found.

Local lending officials may also discriminate against black and low-income applicants for home loans. Since the lending industry in a city is not as atomistic as the general housing market, a city-wide, privately-organized lending cartel is somewhat more plausible than a housing cartel. However, given the ease of secret activity in this service industry, loan-related cartels would not be as stable as manufacturing cartels. Add to these problems the question of incentive. Would lending officials seek favor with high-income households by managing a discriminatory cartel in the housing market? It is more likely that the lenders would see no need for such an alliance. Also, with depositor interest rates and lending rates closely controlled by regulatory agencies, lenders should find little need for added market power developed through a private cartel. On the other hand, national regulatory agencies may create incentives for racial discrimination in conventional mortgage approval rates, if not interest rates. With deposit rate-mortgage rate spreads regulated, lenders give greater emphasis to default risk. If low-income and black households are more risky (perhaps because of their less stable neighborhoods or because of less income and employment stability), then lenders can be expected to steer these categories of borrowers into federally-insured loans instead of conventional loans.

As discussed in the next section, bankers now are required by law to give equal treatment to black applicants for housing credit. A following section is concerned with laws designed to prevent private and local government housing discrimination, whether the discrimination is based on the profit motive or simply a "taste for discrimination," and prejudicial willingness to avoid contact with other population groups even at the sacrifice of a number of profitable transactions. An economist has no difficulty in justifying these laws as improving the allocation of goods and services by outlawing restraint of free trade. This allocative inefficiency exists even in the case of discrimination as an exercise in prejudice. While high-income whites may be partially compensated for

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****The authors are, respectively, Associate Professor of Economics and Associate Professor of Finance, Insurance, and Real Estate, Memphis State University, Memphis, Tennessee.***

their sacrifice of otherwise profitable transactions (compensated by not having to deal with other groups), low-income and black households are strictly worse off from the restraint of free trade. Thus, discrimination is not Pareto efficient. Legal minds see the laws as justified on equity grounds; unequal treatment is unfair.

Despite justification of the new laws, the pace of integration is slow. Are discriminatory conspiracies for profit or from prejudice still untouched, or do the laws run afoul of powerful economic forces that have blunted the force of existing law? Our argument is the second, despite the recognition that prejudice may always exist and that it is more difficult to prove no conspiracy than it is prove one's existence.

Redlining and Racial Lending Patterns

Redlining is a distributional inequality of lending among neighborhoods, where that inequality is not based on cost differences and risk differences among the areas. The Fair Housing Act of 1968 is concerned with criteria for rejecting individuals for mortgage credit, with onerous terms, conditions, and requirements on borrowers, with delinquency and default penalties, and with discouraging some potential borrowers from making application. The Community Reinvestment Act of 1977 adds regulatory concern with any divergence between the source of deposits in federally-regulated financial institutions and the neighborhood placement of loans. The Home Mortgage Disclosure Act requires reporting that allows public scrutiny of these neighborhood patterns.

In lending to one applicant and turning down another, banks may not deny credit because of a policy of restricting funds to neighborhoods with residents of a particular race, religion, or national origin, because of appraisal techniques that assign lower property values in a neighborhood of a mix of races or national origins, or because of categorizing "racially changing" with "deteriorating" neighborhoods. Lenders cannot operate under the assumptions that all neighborhoods will eventually decline or that a property's age is equated to lower value. Finally, pre-screening of loan applicants to discourage some is considered an error of commission. Errors of omission are possible also, for example, failing to encourage applications for credit. Lenders may seek to build loan portfolios that are balanced in terms of loan sizes, property types, and neighborhoods. They may rate neighborhoods by city services and amenities and by the condition and design of property near the property under consideration.

The data reporting requirements of the laws have fostered a number of evaluations of lenders in different regions. Roger Ahlbrandt's study of Pittsburgh is not fully conclusive, but he finds lenders to be more conservative, extending credit in neighborhoods of more than 20.0 percent black residents.[2] Since economic and risk factors were significant in explaining neighborhood differences, Ahlbrandt concludes that the study neither refutes nor supports the hypothesis that redlining exists. Hutchinson, Ostas, and Reed conclude that Toledo lenders' 1970 lending practices stem from risk aversion rather than a taste for discrimination.[3] Their total neighborhood lending regression results were generally plausible with respect to variables not related to redlining, while redlining variables were not successful in indicating the existence of the practice either for mortgages or for home improvement loans. At the same time, Hutchinson, Ostas, and Reed report a u-shaped relation between the proportion of loans not insured by federal agencies and the racial mix of the neighborhood, with the minimum proportion of conventional loans appearing in mixed neighborhoods with 45.0 percent blacks. They argue that redlining would be consistent with continually decreasing proportions of conventional loans as the proportion black increases. The authors consider risk of declining property values to be great in these mixed neighborhoods, reinforcing Ahlbrandt's results.

Thomas King reports statistically significant evidence from 1978 that black and Hispanic applicants for loans are discriminated against in favor of whites in terms of probability of acceptance.[4] King's tests found no significant differences in mortgage terms on approved loans, nor differences in appraisal procedures. These results did not change with sex, age, or marital status, or with location of property within the three cities studied.

George Benston and Dan Horsky criticize the Community Reinvestment Act and the Home Mortgage Disclosure Act.[5] They argue that the acts and the empirical work presented in support of their passage are flawed by the presumption that differences in loan activity among neighborhoods are supply related, caused by the lenders. They believe that inner city areas are made up of older households, having longer tenancy and less turnover, and, thus, lower demand for mortgages. Using sellers' reports on failed sales contracts in Rochester, New York, Benston and Horsky declare that income and credit worthiness explain all significant proportions of the inner city/suburb difference (8.1 percent to 2.4 percent) in sales contracts failing due to denied credit. Addressing the greater proportion of federally insured loans in the city, they argue that there are city/suburb differences in preferences for low down payments versus low monthly notes, also a demand variable.

John Clapp's attempt to model localized lending behavior is designed to include both supply and demand factors in the mortgage market, as well as search and risk variables on the supply side.[6] Theoretical results indicate that lender costs in searching for default risk data are higher per dollar loaned in low-income neighborhoods and in neighborhoods with a low volume of loan transactions. If the higher costs are not legal to pass on to the borrower, it is profitable to ration credit away from the neighborhood. This search cost interest premium is to be added to any risk premium. Since lenders often find data that are consistent with the existence of higher risk in black and low-income neighborhoods, inability to charge different interest rates makes lenders even more reluctant to lend freely in all neighborhoods.

While prohibitions of different conventional mortgage interest rates among neighborhoods appear to be fundamental to equitable treatment of all borrowers, the ban is an important motivation for redlining. Federal housing policies of the past have been criticized in Congress as racially insensitive and guilty of worsening some paths to segregation. In many of those cases, agencies changed policies and laws were modified. There is certainly precedent of altering the course to integrated housing by changing lending regulations.

Siting Subsidized Housing and Zoning To Exclude the Poor

As guilty as the federal government may be, it is local government discrimination against low-income and minority households that lead a federal appeals court judge to write, ". . . it should at least be clear that the most outrageous deprivations of equal rights are those perpetuated by the state itself . . . ."[7] This ruling extended Title VIII of the 1964 Civil Rights Act from cases of individual discrimination to activity by local government. In addition, today a city zoning commission decision to zone a neighborhood white or black or mixed in any particular way would be breaking current interpretations of the Civil Rights Acts of 1866 and 1968 and the Fourteenth Amendment.

Zoning law stems from Justice Southerland's affirmation of a 1922 ordinance in the Village of Euclid, Ohio, that restricted the location of trades, industries, apartment houses, single- and two-family houses, etc.[8] The judge's ruling is that the then new type of ordinance is an evolution of the police power cities may assert for the public welfare. This power has been used to exclude low-income and minority households from high-income localities. By limiting or eliminating zones for multifamily housing units or by requiring costly building and lot sizes and types, low-income households can be kept to a small minority within the city.

Zoning ordinances may also make it impossible to site low-income, publicly-assisted, multifamily housing projects in high-income, predominately white areas that have been zoned for single-family residences. In many cities, the siting of subsidized housing projects is done by housing authorities. If these authorities seek to site the units so as to increase the economic and racial integration of the city, the units will be sited in predominately white neighborhoods. If the objective is to improve low-income housing without forcing integration, then the units will be sited in mixed or black neighborhoods. However, as a large number of cases make clear, the racial motivation of zoning authorities and public housing authorities is not perfectly exposed by the exercise of their power.

Siting public housing projects in a neighborhood and rezoning single-family areas to allow multifamily units both have fiscal effects on the city, effects that would give local authorities motivation for exclusionary votes, regardless of prejudice. Increasing the population density with low-income households yields tax revenue increases that may not match associated increases in costs for public services. Alternatively, zoning to require large, expensive homes on large lots may cause the income and property tax base to increase faster than the cost of services. In this second case, current property owners may enjoy a reduction in tax rate.

Madison Township in New Jersey argued that rapid population growth had to be stopped to stabilize the tax rate.[9] Its restriction of development to 30.0 percent of the township and its two-acre minimum lot size were ruled by Justice Furman to be fiscal zoning, a device to avoid school costs and other costs associated with population increase. It does not serve the public welfare to limit population in the township. However, the Ramapo, New York, community plan was upheld the next year.[10] The restrictions on development there are seen as an effort to implement sequential development and timed growth. While Madison had tried to avoid growth, Ramapo had accepted growth and sought to avoid errors in development that would damage public welfare in the future. However, the need for balanced growth within a city now must be weighed against the need for a city to consider welfare outside its zoning powers. As asserted by the courts in a 1975 ruling, city plans must take into account regional proportions of racial and low-income groups in allocating areas for current development of multifamily housing.[11]

Kenneth Vogel considered the welfare effect of the Mount Laurel decision, estimating that (with a utilitarian social welfare function) education service losses in the township were worth $8 million.[12] His evaluation of the welfare gains in housing makes the total welfare effect ambiguous. However, Vogel argues that if the primary goods are basic liberties, followed lexiographically by economic goods, then the effect of the Mount Laurel decision is to increase the liberty of choosing a home without local government interference.

Conclusion

Vogel adds a final criticism of the development of case law limiting local government's power to exclude low-income and black households. Since only developing areas are treated in the prohibitions and since it is clear that high-income households are better off if they segregate themselves from poorer users of public services, the legal developments encourage the wealthy to move to already fully developed middle and upper-middle class towns. This migration will not serve to integrate America.

With economic incentives so strong to continue using the zoning institution to gain fiscal advantage (or to limit cost increases) through exclusionary zoning, it is hard to imagine a town changing its practices except at the insistence of a court. Exactly the same practicalities will be felt by public housing commissions. Since the effect of their decisions is segregation by economic and racial group, judges will be forced to spend long hours looking for evidence of racial motivation in public meeting transcripts and the acts and words of neighborhood groups objecting to a siting decision or a zoning variance. While some cases will be easier than others, many will remain ambiguous. There is no great hope for swift elimination of the nation's racial segregation.

While the laws prohibiting discrimination in lending are written to be explicit, current law does not offer a final page to neighborhood differences in loan activity. Since some of the difference may be attributed to borrowers, laws directed at lender behavior are inadequate. Thomas King criticizes current laws on several grounds (King, 1980). First he rates the Community Reinvestment Act as uncertain in its goals, plus ambiguous in its requirements. The data reporting requirements of the Home Mortgage Disclosure Act are so inadequate as to prevent a meaningful test for neighborhood damage caused by mortgage insufficiency. No common reporting form is mandated, nor is the reporting period anything other than that selected by different lenders. No report on applications is required, only funds loaned. Thus, no test for discrimination in application review is possible. Finally, only federally-regulated financial institutions must report. Since other lenders (mortgage bankers and insurance companies) may be important lenders in a given neighborhood, the reported neighborhood activity may be completely misleading.

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[1] Clark v. Universal Builders, 501 F.2d 324 (1974).

[2] Roger S. Ahlbrandt, "Exploratory Research on the Redlining Phenomena," *American Real Estate and Urban Economics Association Journal*, vol. 5 (1977), pp. 473-481.

[3] Peter M. Hutchinson, James R. Ostas, and David Reed, "A Survey and Comparison of Redlining Influences in Urban Mortgage Lending Markets," *American Real Estate and Urban Economics Association Journal*, vol. 5 (1977), pp. 463-472.

[4] A. Thomas King, "Discriminatory Mortgage Lending: A Survey of Three Cities," *Monograph Series in Finance and Economics*, no. 4, New York University Graduate School of Business, 1981.

[5] George J. Benston and Dan Horsky, "Redlining and the Demand for Mortgages in the Central City," *Journal of Bank Research*, vol. 10 (1979), pp. 72-87.

[6] John M. Clapp, "A Model of Localized Lending Behavior," *American Real Estate and Urban Economics Association Journal*, vol. 8 (1980), pp. 229-246.

[7] U.S. v. City of Black Jack, 95 S.Ct. 2656, 422 U.S. 1042, 45 L.Ed.2d 694 (1974).

[8] Village of Euclid v. Ambler Realty, 272 U.S. 365, 47 S.Ct. 114, 71 L.Ed. 303 (1926).

[9] Oakwood at Madison v. Madison Township, 117 N.J. Super. 11, 282 A.2d 353 (1971).

[10] Golden v. Ramapo Planning Board, 30 N.J.2d 359, 285 N.E.2d 291, *appeal dismissed*, 409 U.S. 1083 (1972).

[11] Southern Burlington County NAACP v. Mount Laural, 67 N.J. 151, 336 A. 2d 713.

[12] Kenneth R. Vogel, "Exclusionary Zoning and the Provision of Education: An Effect of *Southern Burlington County NAACP v. Township of Mount Laural*," *Journal of Urban Economics*, vol. 8 (1981), pp. 294-312.

[13] A. Thomas King, "Mortgage Lending, Social Responsibility and Public Policy: Some Perspectives on HMDA and CRA," *American Real Estate and Urban Economics Association Journal*, vol. 5 (1980), pp. 77-90.

A PRIMER ON FINANCIAL FUTURES[1]

*Russ Ray**

Financial futures have been described as "the most exciting new financial product in several decades."[2] The *New York Times*, not often prone to overstatement, has predicted that financial futures will eventually change the basic manner in which business is conducted in every sector of money and capital markets.[3] And, indeed, the dollar volume of this new—created in 1975—financial product has already grown to surpass that of even the New York Stock Exchange. This article is offered as a primer for business managers, policy makers, and others who would like to know more about financial futures (also known as interest rate futures) and their tremendous risk-reducing capabilities.

Commodities vs. Financial Futures

Whenever buyers and sellers contractually agree to execute their transactions in the future, such agreements constitute the *futures market*, which of course is distinct from the *spot market* wherein buyers and sellers execute their transactions immediately, or "on the spot." A *futures contract* is a binding agreement to make or take delivery of a specific asset during some month in the future (the *delivery month*) at a price agreed upon today (the *futures price*) in accordance with the rules and regulations of a specific *futures exchange*, such as the Chicago Mercantile Exchange, through which the transaction is cleared. If the particular asset being bought and sold is a "real" (i.e., tangible) asset, such as soybeans or copper, then such contracts are referred to as *commodities futures*. Similarly, if the particular asset being delivered is a financial asset, such as commercial paper or a Treasury bill, then the contracts become *financial futures*.

Futures contracts (or, more simply, "futures") are distinct from *forward contracts* which are advance-pricing agreements directly between buyers and sellers without the involvement of a futures exchange. Today, most forward contracts are between multinational corporations and commercial banks for purposes of buying and selling foreign exchange.

The History of Futures[4]

The practice of futures traces its roots to at least ancient Greece, and by the time of the trade fairs of medieval Europe the technique was considerably refined and used extensively. The first organized futures exchange was physically established in Japan in the early 1600s. Historically, the bulk of futures activities has been in the agricultural sector of the economy, where farmers frequently enter futures contracts in order to assure themselves of guaranteed prices for their output. In the U.S., the first futures exchange was established in Chicago—the marketing hub of the midwestern farm belt—in the mid-1800s as farmers utilized commodities futures to protect themselves from the giveaway prices which often prevailed at harvest time. The Chicago Board of Trade, established in 1848, and the Chicago Mercantile Exchange, established in 1919, together pioneered the development of modern futures trading for not only the U.S., but for the world as well. Even today, these two exchanges continue to comprise the heart of the world's futures trading.

The Social Utility of Futures

From society's standpoint, futures markets serve two basic functions: (1) price reflection and (2) risk reduction. Price reflection is an informational process whereby the expected price of any given commodity during any given month in the future is reflected in that commodity's futures price for the same delivery month. For example, if "Dec corn" were $2.22/bushel—i.e., one could enter into a contract now to buy or sell a standardized (for trading convenience) amount of corn next December at a price of $2.22/bushel—then the market's consensus (i.e., expectation) is that the price of corn next December (ignoring the cost of carry) will be $2.22/bushel.[5] Thus, futures prices are signals to producers informing them of the most profitable commodities to produce, thereby assisting a free-market society in its resource allocation. Of course, market expectations can change, and frequently do.

The second basic function of a futures market—risk reduction, or *hedging*—enables both buyers and sellers of a particular commodity (including money) to minimize the risk of adverse fluctuations in its price by "locking in" beforehand a predetermined (i.e., futures) price. By the same token, when hedgers utilize futures to protect themselves from unfavorable prices which might be in effect at the time of the actual physical transaction, they simultaneously are forced to give up potentially more favorable prices. Such, of course, is the price of certainty. Needless to say, hedging greatly reduces uncertainty and thus facilitates business planning.

The Mechanics of Futures[6]

Perhaps the key to understanding futures is understanding the *basis*, which is the difference between the spot price and the futures price. Because both the spot

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**Assistant Professor of Finance, Central Michigan University, Mount Pleasant, Michigan.*

price and the futures price of any given commodity are basically determined by the same supply and demand factors, they tend to move in tandem so that the basis tends to remain approximately constant in the short run. In the long run, the futures price will tend to converge upon the spot price as the delivery month draws near and these two prices become one and the same. Nevertheless, this tendency of the basis to approach zero as the delivery month draws near is more or less predictable.

The tremendous risk-reducing capabilities of futures can be attributed to the tendency of the basis to remain fairly constant (or at least predictable) and to the fact that either buyer or seller can unilaterally cancel his contract. This latter factor is so because a futures exchange literally interposes itself between every buyer and seller, legally becoming the seller to every buyer and the buyer from every seller. As a result, either party can cancel his futures contract anytime before the delivery date and without the consent of the other party by simply entering into an opposite (and, thus, offsetting) transaction with the same exchange. For example, an individual who had (effectively) contracted to buy a specific type of Treasury bond from the Chicago Board of Trade (CBT) next September could unilaterally cancel his contract by entering into another contract to sell the same type of Treasury bond to the CBT next September, thus negating his contract in a Peter-pay-Paul manner. The individual will incur either a profit or a loss from so cancelling—depending upon the two futures prices at which he first bought and then sold the Treasury bond—and the original seller in the original contract will still be able to sell a Treasury bond next September to the CBT which, like all futures exchanges, interposes itself between every buyer and seller. Approximately 98 percent of financial futures contracts are so cancelled before delivery.

Although the mechanics of futures are, in fact, quite complex, knowledge of just the basis and the process of contract cancellation will enable one to appreciate the tremendous hedging utility of financial futures, as exemplified below.

The Evolution of Financial Futures

In the U.S., interest rates—the price of money—were so stable up until the late 1960s that there literally did not exist a need for a financial futures market since the probability of adverse (or, for that matter, any) fluctuations in the price of money was virtually nil. However, beginning in the early 1970s, a number of factors (such as inflation, the 1971 devaluation of the dollar, and the 1973-74 credit crunch) cumulatively induced an unprecedented rise and volatility in interest rates, thus signaling the need for a mechanism which could provide both the buyers of money (borrowers) and the sellers of money (lenders) protection against adverse fluctuations in the price of money. Such a mechanism was, by definition, a financial futures contract.

After several years of intensive design by financial experts, the first financial futures contract was introduced in October 1975 by the CBT. The contract enabled a user to make or take future delivery of a Government National Mortgage Association ("Ginnie Mae") certificate, chosen in order to help attract capital into the U.S. housing sector which was being crippled by record high interest rates. The contract was an instant success.

A few weeks later the International Monetary Market (the financial futures division of the Chicago Mercantile Exchange) introduced a financial futures contract in U.S. Treasury bills. It, too, was an instant success.

Eager to jump onto a highly successful bandwagon, the American Stock Exchange established its own financial futures subsidiary in 1978, as did the New York Stock Exchange in 1980. Today, these exchanges, along with a few more recent but smaller exchanges, offer financial futures contracts in Ginnie Maes, Treasury securities (bills, notes, or bonds), certificates of deposit, commercial paper, major foreign currencies, stock indices, and even options. As with commodities futures, Chicago is the heart of the financial futures market.

The Short Hedge

In order to appreciate the hedging utility of financial futures, consider the hypothetical example of an institutional investor (such as a pension fund or an insurance company) holding a portfolio of U.S. Treasury bonds which will be sold four months from now in order to satisfy routine cash-flow needs. If the manager of the portfolio is worried that interest rates will rise before the bonds are sold—causing the market value of the bonds to fall[7]—he could hedge this risk in the following manner:

Suppose the manager were holding ten U.S. Treasury bonds (face value: $100,000/bond) each priced at 72-16. Since Treasury bonds are priced at a percentage of face value (and each percentage is subdivided into 32 increments, or "ticks"), each bond is worth $72,500 (= 72 - 16/32% × $100,000), so that the market value of the portfolio is $725,000. The manager could effectively "lock in" the current value of his portfolio by going "short" in (i.e., selling) an equivalent number of Treasury bonds in the futures market. Four months later, if his expectations of higher interest rates are realized, the market value of his spot bonds will be less but—because spot prices and futures prices tend to move in tandem—the market value of his futures bonds will be less as well. As a result, when the manager cancels his futures position four months from now by buying back the same number and type of Treasury bonds, he will be able to do so at a lower price than the price at which he has contracted to sell them, thus incurring a profit in the futures market which will roughly offset the loss in the spot market. This "short hedge" can be depicted as follows:

SPOT MARKET	FUTURES MARKET
Sep 30: Holds ten U.S.	Sep 30: Sells ten U.S.

Treasury bonds each priced at 72-16. Total market value: $725,000.	Treasury bonds (March delivery) each priced at 73-04. Total market value: $713,250.
-Interest Rates Rise-	
Dec 30: Sells these ten bonds which are now priced at 64-08. Total market value: $642,500.	Dec 30: Cancels hedge by buying ten U.S. Treasury bonds (March delivery) each now priced at 65-04. Total market value: $651,250.
Spot Loss: $82,500	Futures Gain: $80,000
Net Loss: $2,500	

Thus, the institutional investor was able to protect itself against the risk of rising interest rates (i.e., falling prices) by hedging this risk in the financial futures market—its net loss after hedging is only a small percentage of what its loss would have been without hedging. Moreover, notice that even if the manager had predicted incorrectly—i.e., interest rates did not subsequently rise, but rather fell—he still would have been able to lock in the current value of his portfolio because the resulting loss in the futures market would have roughly offset the resulting gain in the spot market.

Finally, the question remains as to who would have bought the bonds in the futures market on Sep 30 (i.e., who would have been the opposite party to this contract), and the answer is that this "long" position would have most likely been taken by a speculator who expected interest rates to fall, thus pushing up the value of his futures purchase. This transfer of risk from hedger to speculator is, in fact, the primary economic rationale for a futures market.

The Long Hedge

In order to appreciate how financial futures can be utilized to hedge against the risk of falling interest rates, consider the case of another portfolio manager who has just been notified that in three months he will receive $1 million for long-term investment purposes. The manager intends to invest these funds in Treasury bonds, and he is worried that interest rates will fall significantly in the interim. The manager can hedge this risk—and "lock in" the current rate of interest—by going "long" in (i.e., buying) an equivalent number of Treasury bonds in the futures market. Three months later, if his expectations of lower interest rates are correct, his spot bonds will cost more, but this opportunity loss will be roughly offset by a commensurate gain in the futures market. This "long hedge" can similarly be depicted as follows:

SPOT MARKET	FUTURES MARKET
Apr 1: Manager wants to lock in current high yield on ten Treasury bonds each priced at 87-15 (yielding approximately 9.4%). Total market value: $874,687.50.	Apr 1: Manager buys ten U.S. Treasury bonds (September delivery) each priced at 87-08. Total purchase price: $872,500.
-Interest Rates Fall-	
Jul 1: Manager buys ten U.S. Treasury bonds each now priced at 96-02 (yielding approximately 8.4%). Total market value: $960,625.	Jul 1: Manager cancels hedge by selling ten U.S. Treasury bonds (September delivery) each now priced at 95-31. Total selling price: $959,687.50.
Spot Loss: $85,937.50	Futures Gain: $87,187.50.
Net Gain: $1,250	

Thus, the manager's increased cost of buying the Treasury bonds was roughly offset (but not perfectly offset due to a small change in the basis) by a gain in the futures market. Other costs incurred by the manager would have been commissions and interest foregone on margin deposits.

Cross Hedges and Weighted Hedges

Generally, the best hedging performance is obtained by hedging a particular spot market instrument with its futures counterpart—e.g., spot Treasury bonds are best hedged with futures Treasury bonds; spot certificates of deposit are best hedged with futures certificates of deposit; etc. This is so because the prices in the two markets are determined by the same supply and demand factors and thus move closely in tandem.

Often, however, a particular instrument does not have a futures counterpart (such as prime rate paper), in which case a *cross hedge* must be utilized. A cross hedge utilizes a different futures instrument to hedge the planned purchase or sale of a particular spot instrument. The key to successful cross hedging is to find a futures market instrument whose price behavior roughly tracks the price behavior of the spot instrument being hedged, even though the supply and demand factors of the two instruments might be slightly different. For example, futures CD's would likely be a good cross hedge for a planned prime rate loan, since the two rates roughly constitute a bank's bid/ask spread which can be expected to remain fairly constant.

Hedges can also be either weighted or unweighted. An unweighted hedge is one in which the total face value of the futures market transaction being used as a hedge is equal to the total face value of the spot market transaction being hedged. Both of the examples discussed earlier were unweighted hedges, since ten Treasury bonds in the spot market (total face value: $1,000,000) were hedged with ten Treasury bonds in the futures market (total face value: $1,000,000).

A weighted hedge is one in which the *market* values of both the spot and futures transactions are (approximately) equal. In order to achieve a weighted hedge for any given number of spot instruments, it is generally necessary to buy/sell a different number of futures instruments. Consider, for example, a portfolio manager who wants to hedge $1 million (face value) of AAA-rated corporate bonds—currently priced at 98.75 percent of par—against the risk of rising interest rates. Either an unweighted or weighted hedge could be utilized:

SPOT MARKET	FUTURES MARKET (Unweighted Hedge)	FUTURES MARKET (Weighted Hedge)
May 30: Holds $1,000,000 of AAA-rated corporate bonds priced at 98.75% of par. Market value: $987,500	May 30: Sells ten Treasury bonds (December delivery) each priced at 80-04. Market value: $801,250	May 30: Sells twelve Treasury bonds (December delivery) each priced at 80-04. Market value: $961,500
-Interest Rates Rise-		
Sep 30: Sells bonds now priced at 87.38%. Market value: $873,800	Sep 30: Cancels hedge by buying ten bonds, each now priced at 70-30. Market value: $709,375	Sep 30: Cancels hedge by buying twelve bonds each now priced at 70-30. Market value: $851,250
Spot Loss: $113,700	Futures Gain: $91,875	Futures Gain: $110,250
	Net Loss: $21,825	Net Loss: $3,450

As can be seen from the above illustration, the relative advantage of a weighted hedge is that the resulting gain/loss in the futures market generally tends to more exactly offset the loss/gain in the spot market. This is so, of course, because the full amount of the market value of the spot transaction has been hedged, which is not the case with an unweighted hedge.

Commissions, Margins, and Other Costs

As a percentage of the total dollar volume of the market transaction, both commissions and margins on futures are relatively inexpensive when compared to stocks. Commissions are generally about $50 per contract—a relatively small percentage of, say, a $100,000 futures contract for a Treasury bond.

The relatively low margins for futures—about 2-4 percent as compared to 50-90 percent for stocks—are due to the different purpose of margins for futures. Unlike stock margins, which represent partial payment for a stock purchase, futures margins serve as "security deposits" or "performance bonds" guaranteeing the financial integrity of the parties to a futures contract. Because either buyer or seller could lose money in the futures market if his expectations are incorrect, both sides post margins. As the price of the futures contract changes, each party's margin account is "marked to the market" daily. At the end of each day, each party must have in his margin account an amount sufficient to close out the contract (even if the party has no intention of closing out his contract). This safeguard—which insures continuous financial integrity—will require a party to post an additional margin if the market "moves against him."

For example, consider the case of a hedger who yesterday posted a $3,500 margin in order to sell short a Treasury bond futures contract at 84-13. If the market closed yesterday with the settling price of his contract at 85-13, then the hedger would receive a "margin call" from his broker requiring him to post an additional $1,000 margin today in order to stay in the market. (If the hedger were unable to post the additional margin, his contract would most likely be cancelled.) Although intra-day limit moves ($2,000 for Treasury bond futures) will limit his day-to-day losses, over a period of time a hedger who hedged against incorrect expectations could experience a significant loss.

Another hedging cost to be considered is the opportunity cost of the money posted for margin. For large hedges involving a significant number of contracts over a significant period of time, such a cost could be considerable.

Finally, the firm must consider the cost of the in-house managerial expertise necessary for successful hedging. If the firm intends to continuously hedge its financial transactions, it would probably be wise to incur the cost of having in-house hedging experts who know the intricacies of the firm's operations much more intimately than the futures brokers or consultants on whom it would otherwise have to rely.

Other Hedgers

Who else can hedge the risk of volatile interest rates by using financial futures? Just about anyone who lends, borrows, or holds money in any form. A corporation or a municipality planning a bond issue six months from now, but worried that interest rates will rise significantly in the interim, could "lock in" today's borrowing rate by going short in the financial futures market so that higher borrowing costs six months from now are roughtly offset by gains in the financial futures market. Institutional investors planning future investments, but concerned that interest rates will drop before those investments can be made, can effectively lock in today's investment rate by going long in financial futures. Thrift institutions regularly protect the value of their mortgage portfolios against rising interest rates by short positions in financial futures. Similarly, banks, securities dealers, brokerage firms, finance companies, and many others can hedge the risk of doing business in today's uncertain world by utilizing financial futures. So long as interest rates exhibit any volatility whatsoever—real or potential—financial futures will remain a viable means of hedging against the uncertain cost of money.

Conclusion

In just a few short years financial futures have become one of the most important and welcome innovations in finance. By minimizing the risk associated with volatile and seemingly capricious interest rates, financial futures have injected the needed element of certainty into the savings and investment function, thereby helping to increase savings and investment. And, as any student having had Econ. 101 will quickly point out, increased investment within a society eventually raises that society's real standard of living.

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[1] This paper has benefited considerably from the helpful comments of an anonymous referee.

[2] M. Powers and D. Vogel, *Inside the Financial Futures Market* (New York: John Wiley and Sons, 1981), p. 3.

[3] "Financial Futures: New Hedge," *The New York Times*, December 28, 1978, p. D-1.

[4] For a more detailed history of futures than that which is contained in this article, see A.M. Loosigian, *Interest Rate Futures* (Homewood, Illinois: Dow-Jones-Irwin, 1980).

[5] If this were not the case, then the process of arbitrage would make it so.

[6] The following constitutes the briefest of introductions to a subject matter which is quite complex. For a more thorough introduction, see Kolb [1982], Loosigian [1980], or Powers and Vogel [1981].

[7] The inverse relationship between the interest rates (or "yields") on fixed-income securities and their prices can perhaps best be exemplified by considering a "consol," which is a bond that never matures. If a particular consol paid $100 interest per year (a fixed amount) and if its current market price was $1,000, then its "current yield" (= dollar interest ÷ market price) is 10 percent. If, subsequently, other consols of comparable risk began yielding 20 percent, then the market price of this consol must drop to $500 in order for it to offer the going yield of 20 percent—otherwise, no one would buy it. Similarly, if the other consols had subsequently yielded 5 percent (instead of 20 percent), then the market price of this consol would have increased to $2,000 in order for it, again, to offer the competitive rate of interest. Thus, rising interest rates cause the prices of fixed-income securities such as bonds to fall, and vice-versa.

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INTERNATIONAL LICENSING: SOME STRATEGY CONSIDERATIONS

*Allan C. Reddy, Chauncey S. Elkins, and C.P. Rao**

Introduction

American firms planning to enter foreign markets should carefully evaluate licensing as a viable alternative to equity participation. The current international environment is not very conducive to equity investment, for today's world is embroiled in political and economic uncertainties. In addition, rampant nationalism and stiff competition in international markets limit any form of direct investment. In addition, there is a greater risk of expropriation and reluctance to "foreign" investment among host nations. Under these circumstances, though licensing is less profitable than other alternatives, it could be a proper strategy for international expansion. There are other forms of agreements such as international franchising, turnkey projects, cooperation agreements, etc., that share the characteristics of licensing. These are not discussed in this article, as many aspects of licensing are similar to these other forms. The focus of this article is to review the strategic considerations in international licensing and to discuss the salient aspects of which managers should be aware.

International Licensing

Broadly defined, international licensing includes a variety of contractual agreements whereby domestic companies (licensors) make available their *intangible* assets (patents, trade secrets, know-how, trademarks, and company name) to foreign companies (licensees) in return for royalties and/or other forms of payment. Usually, the transfer of these intangible assets or property rights is accompanied by technical services to ensure the proper use of the assets.

American firms earn billions of dollars annually through licensing agreements. In 1976, American firms received more than $2 billion in licensing revenues, which included income from royalties, technical assistance fees, sale of components and raw materials, and engineering services. It has been estimated that licensing revenues of American firms possibly have quadrupled during the eighties. Originally, big firms such as GM, Ford, Singer, IBM, and Coca-Cola were involved in licensing abroad. Now the trend appears to be that small and medium-sized firms are showing greater interest in licensing because of its low risk and low investment feature.

The following represent a few examples of successful licensing among small and medium-sized business firms: A leading American producer of building materials has 58 foreign licensees who provide an annual net contribution of $2 million after taxes. Spalding Company, a sporting goods manufacturer, receives more than $2 million revenue through international licensing. The Fruit of the Loom Company, whose brand name is popular in sheets, pillowcases, hosiery, etc., does not manufacture anything by itself. The firm lends its name and expertise for a return of at least 1.0 percent of the licensee's gross sales. Marubeni Corporation of Japan uses the Fruit of the Loom name on 45 consumer items. Porelon, Inc., a Johnson Wax subsidiary, like Fruit of the Loom, does not manufacture anything but its raw material, a special ink used in disposable type hand stamps under the name Perma-Stamp. Porelon has licensing agreements with 15 licensees in the domestic market and another 15 overseas. To supervise its overseas operations, the firm has established a European subsidiary in Amsterdam, Netherlands.

The Advantages and Disadvantages of Licensing

Any discussion on licensing is incomplete without the mention of its advantages and disadvantages. The following are some important advantages to a licensor.

1. Licensing requires less or little capital and therefore serves as a quick and easy method of entry to foreign markets.
2. In some countries, especially among the developed nations and the communist countries, only licensing is allowed.
3. For products which are in the maturity stage of their life cycle, licensing provides life extension and an outlet for a firm to make extra profits in foreign markets.
4. Licensing is a good alternative to foreign production and marketing in an environment where there is worldwide inflation, shortage of skilled labor, increasing domestic and foreign government regulations and restrictions, and tough international competition.
5. The royalties through licensing are guaranteed and periodic, whereas the share income from investment fluctuates yearly and is risky.
6. Through a technical feedback arrangement, American firms can benefit from product developments without research expense.
7. When exports are no longer profitable due to intense competition, licensing is a good alternative.

**The authors are, respectively, Associate Professor and Professor of Marketing, Valdosta State College, Valdosta, Georgia, and Professor of Marketing, University of Arkansas, Fayetteville, Arkansas.*

8. Licensing overcomes the problem of high transportation costs which make the export of some products noncompetitive in target markets.
9. Licensing is immune to expropriation, because the licensor does not own any physical assets in the target country.
10. In some countries (even among Western nations), manufacturers of military equipment or any product deemed critical to the national interest (such as communication equipment) may be compelled to enter licensing agreements.

Even though the advantages of licensing far outweigh the disadvantages, managers need to be aware of some important disadvantages of licensing in order to formulate better strategies. Some disadvantages are as follows:

1. To initially attract licensees, a firm must possess a distinctiveness in technology, trademark, and company/brand name that is attractive to potential foreign users.
2. The licensor has no control over production and marketing of the licensee firm.
3. Compared to share income from equity investment, licensing royalties are negligible. Royalty rates are restricted by the host government, seldom exceeding 5.0 percent of gross/net sales.
4. There is the risk of a licensee losing interest in renewing the contract unless the licensor firm keeps holding the interest of the licensee through innovation and new technology.
5. There is a danger of creating competition in third markets or even in home markets if the licensee violates territorial agreements. Currently, there is no international court to solve such disputes, even though going to court is always time consuming and expensive. Thus, the opportunity cost of licensing, i.e., the cost of not being able to enter the market in another way, may be high. This may be moderated, but not eliminated, through contract provisions.

Presented below is a discussion of the significance of a market study, profitability analysis, contract agreement, and bureaucratic hurdles.

Market Study

A thorough market study is paramount to the success of international licensing. An inadequate market study has been the primary reason for most failures in international licensing.

The market study should include estimates of the market potential, industry potential, and company sales potential. The last category should be classified by territory, product type, and customer segment. A thorough analysis of the market provides additional strength for the licensor in bargaining better terms and conditions from the licensee. Most important, of course, the sales estimates help develop profitability analysis.

In conducting a market study, firms should be cautious not to overspend. Depending on the distance from the U.S. of the prospective market, foreign travel for research purposes can be extremely expensive. Therefore, it is better that the market study be divided into two phases. The first phase should involve collecting and analyzing information that can be easily obtained within the U.S. Then, when this source is exhausted and the company decides to proceed further, the second phase should include first-hand investigation of foreign markets by company personnel and researchers.

Secondary Sources of Information

There are many secondary sources of information about foreign markets that are available within the U.S. There is usually no difficulty in securing reliable statistics on total population, total foreign trade, gross national product, and the like. In fact, data from U.S. sources are preferable to that from foreign sources because of the complexity of converting foreign currencies into American dollars and difficulties of interpretation.

Some important secondary data sources are:

The United Nations
The International Monetary Fund
The U.S. Chamber of Commerce
The U.S. Department of Commerce
The National Industrial Conference Board
National Foreign Trade Council
Business International, Inc.
Foreign embassies

Some of these organizations regularly collect information on foreign markets and periodically publish data for the benefit of their subscribers. For example, the *U.N. Monthly Statistical Bulletin* and I.M.F.'s *International Financial Statistics Series* provide reliable and up-to-date sources of economic background information and monthly statistics on various countries.

Profitability Analysis

The neglect of a systematic analysis of expected profits from the proposed licensing venture can lead to two types of problems: One is *underlicensing*—not licensing when one should; the other is *overlicensing*—licensing when one should not.

Profitability requires that managers make estimates of both incremental revenues and incremental costs projected over the lifetime of the venture. The *profit contribution of the venture* is then calculated by subtracting all incremental costs from all incremental revenues.

After estimating royalty revenues based on the market study, the firm needs to identify and estimate other kinds of licensing revenues, including:

Lump-sum royalties (including disclosure fees)
Technical assistance fees
Engineering or construction fees
Equity shares in licensee firm
Dividends on equity shares
Profits from sales to licensee (machinery, equipment,

raw materials, components, or nonlicensed products)
Profits from purchase and resale of goods manufactured by licensee
Savings from use of licensed products in licensor's own operations
Commissions on purchases or sales made for licensee
Rental payments on licensor-owned machinery or equipment
Management fees
Patents, trademarks, and know-how received from licensee (grantbacks)

After estimating all revenues, the licensor firm projects the aggregate cash inflows that are anticipated over the life of the proposed licensing venture. The next step is to estimate various incremental costs. These are classified as opportunity, startup, and ongoing costs.

Opportunity Costs

Loss of current export or other net revenues
Loss of prospective revenues

Startup Costs

Investigation of target market
Selection of prospective licensee
Acquisition of local patent/trademark protection
Negotiation of licensing agreement
Preparation and transfer of blueprints, drawings, and other documents
Adaptation of technology for licensee
Training licensee's employees
Engineering, construction, and plant installation services
Contribution of machinery, equipment, and inventory to licensee

Ongoing Costs

Periodic training and updating of licensee
Maintaining local patent/trademark protection (including policing and litigation costs)
Quality supervision and tests
Auditing and inspection
Marketing, purchasing, and other nontechnical services
Management assistance
Correspondence with licensee
Resolution of disputes
Maintenance of licensor staff

Since the time paths of revenues and costs will differ, it is desirable to use net present values in calculating the profit contribution. The resulting figure should then be compared with the estimated profit contributions of alternative entry modes to decide which is the most appropriate and profitable mode of entry for a given venture.

Patent Protection

Protecting one's patent is an important consideration in licensing. Therefore, some points in connection with patent protection are worthy of note here. Among the various types of licensing agreements such as patent, trademark, copyright, franchise, etc., patent license agreements are the most popular. In this, the licensor grants the licensee either exclusive or non-exclusive rights to the use of a process or product. It cannot be assumed that a patent issued in the United States will have automatic protection in a foreign country, since most countries have their own laws concerning patents. It is, therefore, essential that an American firm register its patent in as many countries as possible, even though a country's market is not of immediate concern to the firm. A recent development in this regard is multiple country patent protection. Under the International Convention for the Protection of Industrial Property ("the Paris Union"), a company that files an original patent claim in one member country has a "right of priority" in filing claims in other member countries for a period of one year following the original filing. About 80 countries belong to the Convention, including all industrial countries and the European Communist countries except Albania. There are similar agreements among European nations also for protecting the member countries' firms. But, most developing countries will remain outside any international agreements.

The Contract Agreements

Foreign licensing involves two or more cultures with all the possible differences in language, judiciary practice/system, and business customs. Even though the terms and conditions in a contract have been clearly stated, difficulties between two parties may arise in the interpretation of the contract. One should remember Peter's Principle, "If anything can go wrong, it will go wrong at the worst possible moment."

Since the contract agreement is the chief instrument of control in international licensing, expert legal counsel is required in preparing the agreement so that future misunderstandings are either minimized or totally avoided.

The contract serves four important purposes: (1) provides licensor protection against any infringement of the patent; (2) assures regular and periodic payment of royalties; (3) provides a right to licensor to inspect operations of the licensee; and (4) provides the licensee with a minimum work performance guarantee by the licensors, and the scope and extent of such responsibilities.

The contract agreement should spell out how disputes between the licensor and licensee should be resolved. More specifically, the contract agreement should consist of the following:

Definition of the parties to the agreement
Specifications of the products or processes to be licensed
Specifications of exclusive or nonexclusive nature of the contract
Whether sublicensing is allowed or not
Territorial assignment
Definitions of patent, existing know-how, future know-how, and trademarks subject to the license
Cross-licensing of know-how or patents developed by the licensee
Who pays licensing fees and local taxes

Legal action against a third party in case of infringement of patent
Duration, termination, and the parties' rights after termination
Assignability of purchase ownership of any share of the licensee
Arbitration clause and applicable law attributed to a specific country of jurisdiction

Bureaucratic Hurdles

In negotiating as well as executing a contract agreement with a foreign firm, one cannot underestimate the significance of bureaucratic hurdles from the government involved, especially the host governments. Therefore, failure to understand the host government's (especially if it is a developing nation) rules, regulations, and various government officials and their behavior is rather important to avoid hurdles and to have a smooth operation of the licensing agreement. For example, in most developing countries, it is typical that a document which needs governmental approval will not get sanctioned until someone in charge of it is taken care of (bribed or coerced). The approval of the license agreement, payment of royalties, payment of taxes, renewal of the license, etc., are all potential problem issues in this regard. To avoid problems such as these, some American firms appoint local businessmen as agents. These agents will "oil the wheels" of the host government's bureaucracy and get the job done for the sponsor. The licensor firm usually pays a retainer fee for this complicated task. Occasionally, foreign banks (American banks, for example), operating in the host nation may also be willing to undertake such tasks as an obligation to their valuable (American) customers.

Conclusion

In spite of the problems that are inherent, licensing still provides an opportunity for American firms to enter foreign markets and earn extra profits with a great deal less risk. One should remember that the present international environment is far from conducive for any equity investment and most nations now are reluctant for "foreign" equity investment in their countries. Also, when capital is limited, as in the case of small and medium-sized firms, licensing provides an opportunity to penetrate foreign markets. Last, but not least, managers can rationally choose licensing as an entry mode only when they make sure that the expected profitability of a proposed licensing venture justifies such an undertaking (in comparison with the same or other alternatives including exporting and equity investment). It is expected that the future for American business in international markets lies in the licensing area.

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A LAYMAN'S GUIDE TO TENNESSEE STATE GOVERNMENT TAXES

*Howard P. Tuckman and Margaret Taylor**

A great deal of interest has been expressed recently in how Tennessee state government is financed, in part due to interest in how tax reform might lead to a better tax structure. This article is designed to provide a summary of what the major taxes in Tennessee are, when they were enacted, and what they contribute to state and local revenues.

The Taxes Levied by the State

Tennessee state government has 19 major taxes. In alphabetic order, they are as follows:

Alcoholic Beverage Taxes: Chapter 40 of the Public Acts of 1939 authorized the sale of alcoholic beverages. The present tax rate is $4 per gallon on distilled spirits and $1.10 per gallon on wines. Wine made in Tennessee from Tennessee products is taxed at a lower rate—5 cents per gallon. In addition, a tax of 15 cents per case sold is paid by the wholesaler to cover administration and enforcement expenses. Licenses and permits are issued annually at the following rates: manufacturer, $1,000; wholesaler, $1,000; retailer, $500; winery, $500; manufacturer's representative, $50; wholesaler's representative, $10; and employee's permit, $2.

Chapter 341 of the Public Acts of 1979 also taxes any brand of alcoholic beverage which is registered in Tennessee. The tax is $250 on distilled spirit brands with wholesale sales of 250 cases or more and $100 on distilled spirit brands with less than 250 cases of wholesale sales. Revenue collected from these taxes is apportioned by statutory formula: 83.0 percent to the General Fund and 17.0 percent to the counties.

Beer Tax: The Tennessee beer tax was enacted in 1939. The present rate is $3.90 per barrel. In addition to the gallonage tax, registration fees are levied at the following rates: $40 for manufacturers, $20 for wholesalers, and $10 for retailers. Annual $5 transportation permits are also required for non-common carriers transporting beer into the state.

Revenue collected from the beer tax is divided between the state and its local governments. The General Fund receives approximately 68.0 percent of the revenues, the counties and municipalities receive approximately 20.0 percent, and the litter control program receives 12.0 percent. The wholesalers also collect a gallonage tax of 17.0 percent of the wholesale price from the retailers. This is paid to the respective city or county governments, except for 0.5 percent which is kept by the state.

Business Tax: The Business Tax Act imposes a minimum tax on the gross receipts of businesses. Taxable privileges are separated into five basic groups or classes with specific rates for each. Originally, cities and counties were given jurisdiction over retail operations, while the state taxed wholesale operations. The law was later revised so that the wholesale tax was transferred to local units of government. The cities and counties transmit 15.0 percent of the amount collected to the state to replace the wholesale taxes given up.

Corporation Filing Fees: Chapter 12 of the Public Acts of 1929 provides for the payment of an annual filing fee by every corporation doing business in Tennessee. This fee is set at one-half percent of the gross receipts from business conducted entirely within the state ($25 minimum). As its option, a corporation can pay a fee based on its capital stock.

Excise Tax: The excise tax was the first Tennessee corporate tax to be enacted (1923). It is the second largest source of state owned tax revenues. The present rate is 6.0 percent. All corporations, cooperatives conducted for profit, joint stock associations, business trusts, state banks, national banks, and savings and loan associations must pay an annual excise tax on net earnings from business conducted within the state. Corporate earnings do not include dividends from other corporations if they are at least 80.0 percent taxpayer owned. Earnings do not include income derived from bonds and other similar obligations of the state of Tennessee.

Franchise Tax: The Tennessee franchise tax was enacted in 1937 as a tax on the privilege of engaging in business in corporate form. The present tax rate, unchanged since 1937, is 15 cents per $100 of corporate stock, surplus, and undivided profits of domestic and foreign corporations in Tennessee. The minimum tax is $10. The tax base cannot be less than the actual value of the property owned or used in Tennessee.

Gasoline Tax: Enacted in Chapter 58 of the Public Acts of 1923, the gasoline tax first was levied at a rate of 2 cents per gallon of gasoline sold. It was enacted to provide revenue for the construction and maintenance of the public highways. By 1931, the rate had been raised to 7 cents per gallon, and effective July 1981 the rate was increased to 9 cents per gallon.

The tax is levied on every gallon of gasoline or distillate refined, manufactured, sold, stored, or imported into the state. Refunds are granted on gasoline used for agricultural purposes, while political subdivisions and government agencies are exempt from payment of this tax.

Special Petroleum Tax: The gasoline inspection fee was enacted in 1899 for the purpose of assuring that gasoline and oil sold in the state met minimum quality standards.

**The authors are, respectively, Distinguished Professor of Economics and Graduate Assistant, Memphis State University, Memphis, Tennessee.*

MID-SOUTH ECONOMY

BUREAU OF BUSINESS & ECONOMIC RESEARCH THE FOGELMAN COLLEGE OF BUSINESS AND ECONOMICS MEMPHIS STATE UNIVERSITY

STATISTICAL SUPPLEMENT

THE MID-SOUTH ECONOMY

Preliminary data for the first quarter of 1983 underscore the tentative proclamation that a recovery is underway. National economic indicators support the view that the economy is back on an expansion path after its rugged detour in 1982. Industrial production is slowly rising, inflation remains low, and short-term interest rates are a point and a half below double-digit. Consumer confidence, as well as their financial position, is improving. This is expected to get the economy started and sustain it for awhile. But most economic observers conclude that business investment will be needed to keep the economy moving ahead. Right now, interest rates remain the major area of concern because rising interest rates could choke off consumer and business spending, preventing the economy from achieving consistent economic growth. The general outlook for 1983 is that first-half growth will be slow by normal recovery standards, with moderate expansion in the second half causing unemployment to drop below the 9.0 range by year's end. The key to this scenario rests on a continued downward bias to inflationary expectations which is vital before interest rates can be expected to move lower in 1983, thus providing the needed stimulus for increased consumer and business spending.

For the Mid-South, total personal income grew 4.7 percent from third quarter 1981 to third quarter 1982, underperforming the national increase of 5.6 percent. Sales tax collections are showing signs of improving from a year ago, which should help alleviate some of the recent strains on state budgets. Mid-South savings and loans are also experiencing a substantial turnaround in both their mortgage lending and net savings flows. A recent report by the Tax Foundation, which estimated the per capita federal tax burden for each state in 1983, ranked the Mid-South states as follows: Louisiana (35th), Tennessee (37th), Alabama (47th), Arkansas (50th), and Mississippi (51st).

Labor

Aggregate unemployment in the Mid-South crept up to 13.2 percent in January 1983, 1.3 percent above the January 1982 level of 11.9 percent. Non-agricultural wage and salary employment registered declines across-the-board for the Mid-South states. Manufacturing employment continues to experience substantial declines from the levels of a year ago. Non-manufacturing employment registered little change in the nation, with Alabama and Arkansas the only Mid-South states to register gains from their 1982 levels.

Average weekly earnings of production workers in the Mid-South underperformed the national increase of 8.9 percent, with Mississippi registering the best performance, up 7.3 percent from last January. Average hourly earnings registered gains across the Mid-South states, with Tennessee experiencing the best gain at 7.7 percent. One of most notable signs of improvement in the employment sector is the 5.4 percent gain in average weekly hours for production workers in the nation.

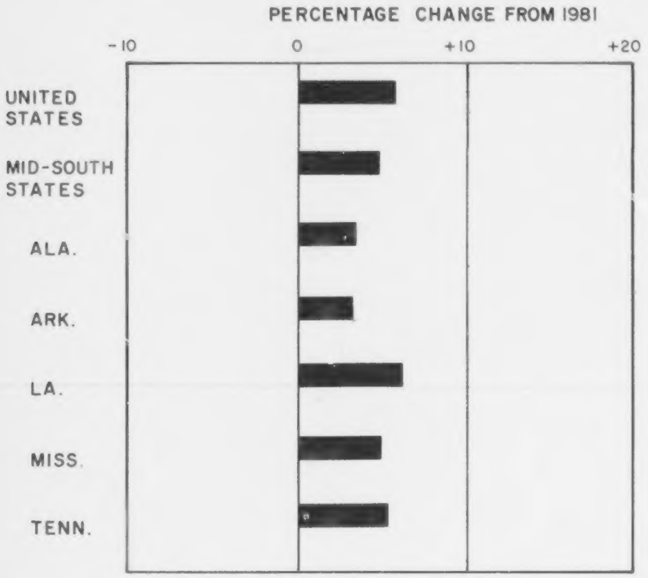
Construction

One of the more encouraging signs to emerge during the period has been the rebound in the housing industry. Housing starts have been increasing, and the number of permits, an indicator of future activity, has increased 63.0 percent since last June. Increased activity in the housing market should help generate momentum behind the economic recovery. Housing construction requires the utilization of lumber and steel, while increased home sales lead to increased sales of consumer goods, especially durable goods like appliances and home furnishings.

Alabama continues to experience declines across-the-board in construction activity, with Louisiana and Tennessee registering gains in every category. Mississippi also experienced substantial increases in the residential sector but fell 6.8 percent in non-residential building.

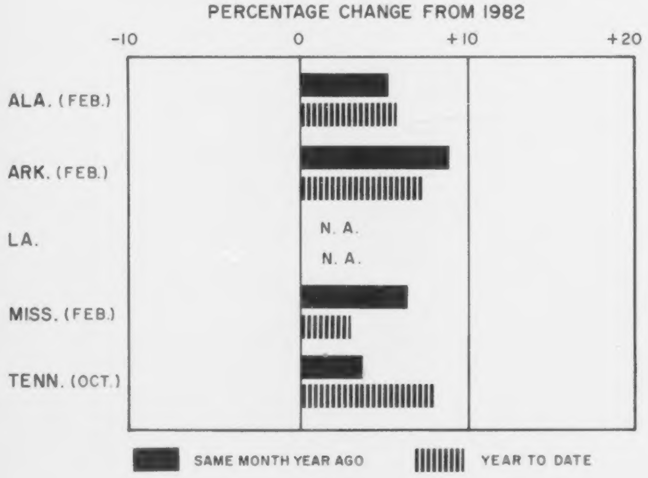
The April 1983 issue of *Work Boat* magazine provided a preview of the construction budget for the Corps of Engineers for fiscal 1984. Alabama is scheduled to receive $90.0 million for construction of the Tennessee-Tombigbee waterway. Arkansas is expected to receive $9.0 million for work on the Quachita and Black rivers. Louisiana will receive $63.7 million for its Red River

PERSONAL INCOME - III QTR. 1982

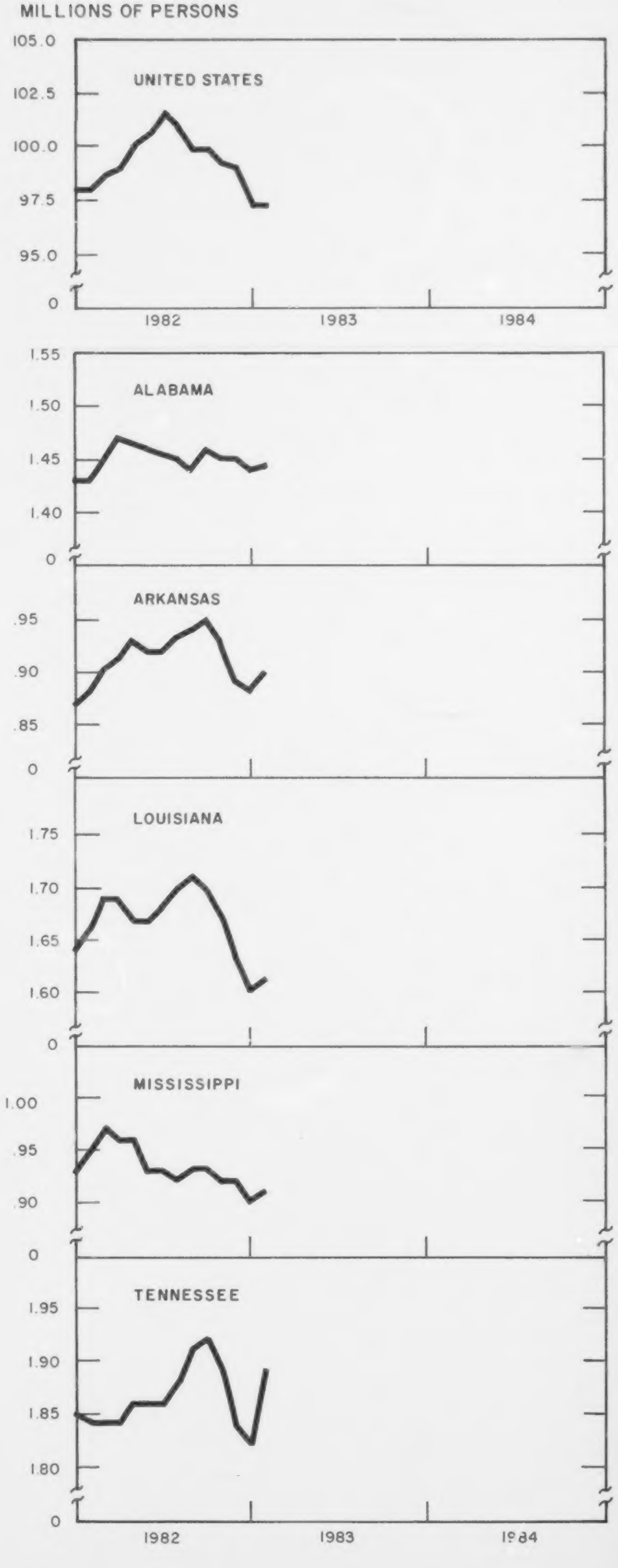


SOURCE: BUREAU ECONOMIC ANALYSIS

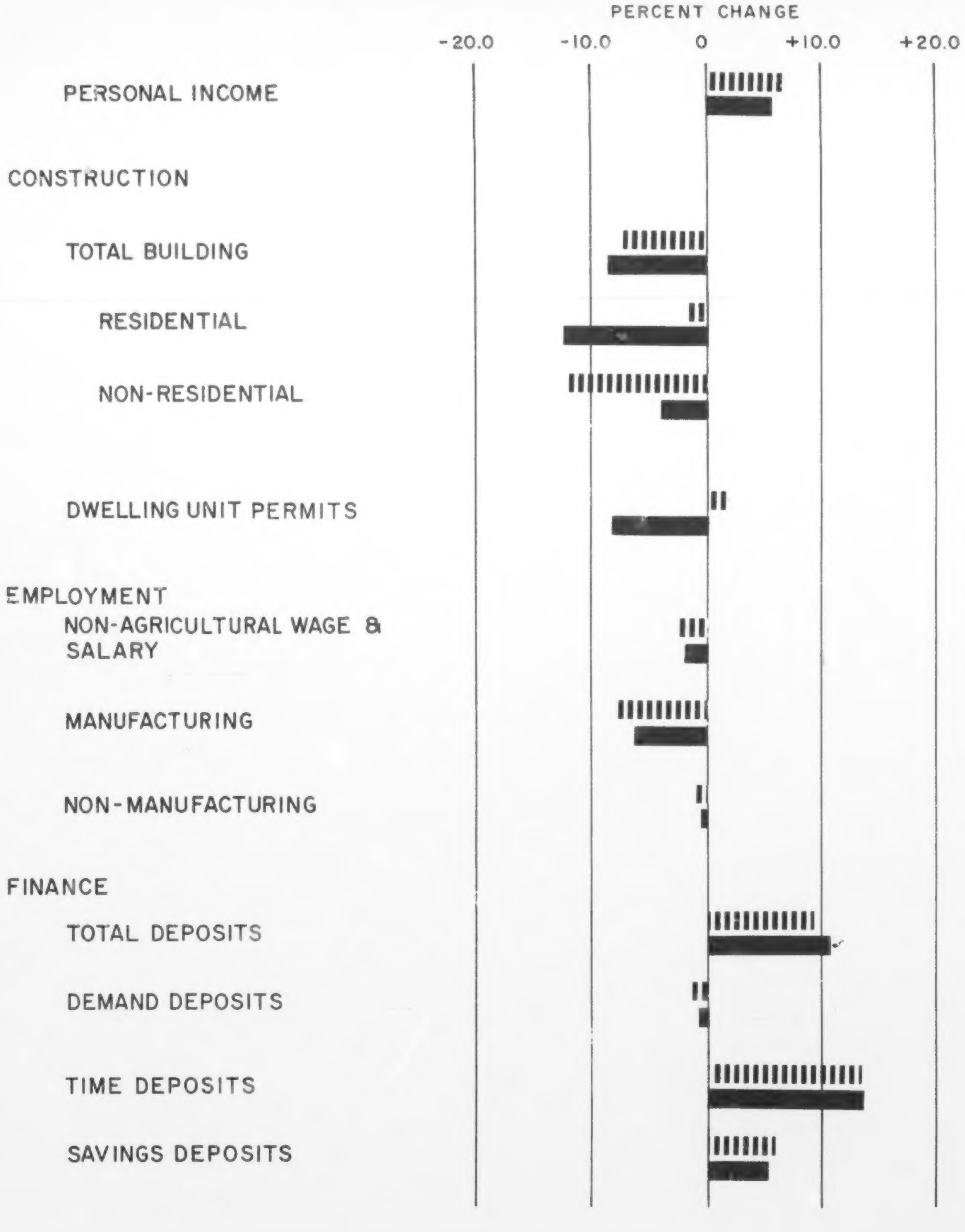
SALES TAX COLLECTIONS 1983



TOTAL EMPLOYMENT



THE MID-SOUTH ECONOMY AND U.S. ECONOMY
1982 COMPARED WITH 1981



SOURCE: SURVEY OF CURRENT BUSINESS; FEDERAL RESERVE BANK OF ATLANTA; BUREAU OF ECONOMIC ANALYSIS; STATE EMPLOYMENT SERVICES; U.S. DEPARTMENT OF AGRICULTURE.

ANALYSIS OF ANNUAL CHANGES IN THE MID-SOUTH ECONOMY
1982

The consensus forecast for 1982 called for slow growth during the first half of the year, with moderate rates of growth in the second half lifting us out of the recession. But by year's end, the economy had performed at one of its lowest levels in the post-World War II era. The overall decline in real Gross National Product in 1982 was moderate by most standards, -1.2 percent from fourth quarter 1981 to fourth quarter 1982. But the nation's industrial base was producing at two-thirds its capacity, and the unemployment rate had climbed to the 10.5 percent range. In addition, the nation continued to import more merchandise than it exported, pushing the merchandise trade deficit above $36.0 billion for 1982. However, monetary policy changes by the Federal Reserve, that began in August 1982, brought sharply lower short-term interest rates and declining long-term mortgage rates providing stimulus to the depressed equity and housing markets. Dramatic improvements were made on the inflation front with a 1982 increase of 6.1 percent, a drop of 4.3 percent over the 1981 increase of 10.4 percent. Finally, 1982 marked the first year the Gross National Product reached over $3.0 trillion dollars (1978 was the first year GNP toppled the $2.0 trillion level), and the Dow Jones Industrial Average (DJIA) finished the year above the infamous 1,000 mark.

Total personal income in the Mid-South increased 5.4 percent for the first nine months of 1982 compared with the same period in 1981. This was 1.1 percent below the national increase for the comparable 1981-82 period and less than half the 13.1 percent increase registered for the first nine months of 1981 versus the comparable period for 1980. Louisiana was the only Mid-South state to outperform the national increase.

Table 1
1982 PERSONAL INCOME AND PERCENTAGE CHANGE FROM 1981

Area	Personal Income First 9 Months, 1982 (Millions)	Percent Change from First 9 Months, 1981
United States	$1,914,307	+6.5
Mid-South Region	116,868	+5.4
Alabama	24,501	+3.1
Arkansas	14,330	+4.7
Louisiana	32,614	+7.4
Mississippi	14,823	+3.8
Tennessee	30,600	+6.5

Source: *Business Week*, February 7, 198

Mid-South sales tax collections (excluding Louisiana) totaled $2.6 billion in 1982, a 0.4 percent decline over 1981. Tennessee registered the largest decline over 1981—off 2.7 percent—with Alabama turning in the best performance with a gain of 3.4 percent.

Table 2
1982 MID-SOUTH SALES TAX COLLECTIONS AND PERCENTAGE CHANGE FROM 1981

Area	1982 Collections (Thousands)	Percent Change from 1981
Mid-South States[1]	$2,692,659	-0.4
Alabama	562,207	+3.4
Arkansas	365,098	+1.5
Louisiana	N.A.	N.A.
Mississippi	621,472	-0.2
Tennessee	1,143,882	-2.7

[1] Excludes Louisiana.

Source: State Department of Revenue.

Unemployment continued to capture the spotlight in 1982, with the aggregate unemployment rate for the Mid-South at 12.9 percent in December 1982, one full percentage point above the July 1982 rate and 2.6 percent above the December 1981 level. Manufacturing employment carried the brunt of the decline in employment with 6.3 percent fewer production jobs in December 1982 than a year ago. However, a recent study compiled by Alexander Grant and Company and the Conference of State Manufacturers' Associations, which ranked the states (excluding Alaska and Hawaii) on twenty-two measurement factors which reflected the business climate each state offered manufacturing firms in 1982, ranked the Mid-South states as follows: Mississippi (9th), Louisiana (12th), Tennessee (13th), Arkansas (18th) and Alabama (23rd). These favorable rankings might tend to indicate that the declines in manufacturing employment in the Mid-South are more related to the national recession than to the possible exiting of firms due to an unfavorable business climate. Topping the list of factors, which were weighted in accordance with manufacturers' assessments of their relative importance, were energy costs, wage levels, degree of work force unionization, workers' compensation insurance rates, and unemployment benefits.

The Mid-South civilian labor force totaled 7,776,900 in December 1982, an increase of 358,800 from last December, or 4.8 percent. The total number of persons unemployed in the Mid-South climbed slightly above the one million mark, an increase of 30.9 percent from December 1981. The convergence of a growing labor force and growing unemployment wrecked havoc on both manufacturing and non-manufacturing jobs, resulting in a decline of 2.0 percent in total non-agricultural wage and salary employment in the Mid-South region, slightly

Table 3
LABOR, DECEMBER 1982, AND PERCENTAGE CHANGE FROM DECEMBER 1981

LABOR DECEMBER 1982	United States	Mid-South States				
		Alabama	Arkansas	Louisiana	Mississippi	Tennessee
Civilian Labor Force	110,477,000	1,726,400	1,011,500	1,855,000	1,038,500	2,145,500
Percent Change Year Ago	+ 1.7	+ 3.6	+ 1.4	- 0.4	- 0.7	+ 1.6
Unemployed	11,628,000	275,100	107,600	215,400	118,400	285,900
Percent Change Year Ago	+29.0	+50.7	+12.0	+34.0	+25.4	+32.1
Unemployment Rate						
-1982	10.5	15.9	10.6	11.6	11.4	13.3
-1981	8.3	11.0	9.6	8.6	9.0	10.3
Non-Agricultural Wage & Salary Employees	89,311,000	1,316,600	725,600	1,607,100	794,900	1,688,400
Percent Change Year Ago	- 2.3	- 2.7	- 1.3	- 2.7	- 3.3	- 2.7
Manufacturing Employment	18,134,000*	326,200	190,200	199,000	200,300	467,800
Percent Change Year Ago	- 7.8	- 8.3	- 7.0	- 8.5	- 8.1	- 5.2
Non-Manufacturing Employment	70,384,000*	990,400	535,400	1,480,100	594,600	1,220,600
Percent Change Year Ago	- 0.8	- 0.6	+ 1.0	+ 3.2	- 1.6	1.7
Average Weekly Earnings of Production Workers in Manufacturing	$344.99	$295.94	$271.47	$401.38	$261.70	$289.93
Percent Change Year Ago	+ 4.5	+ 3.2	+ 6.1	+ 4.6	+ 8.4	+ 4.8
Average Weekly Hours of Production Workers in Manufacturing	39.7	40.1	39.4	42.7	40.2	39.5
Percent Change Year Ago	- 0.5	+ 0.2	+ 0.2	+ 1.2	+ 3.6	- 1.0
Average Hourly Earnings of Production Workers in Manufacturing	$8.69	$7.38	$6.89	$9.40	$6.51	$7.34
Percent Change Year Ago	+ 5.1	+ 2.9	+ 5.8	+ 4.9	+ 4.7	+ 5.9

*Seasonally adjusted.

Source: Departments of Employment Security and *Survey of Current Business.*

outperforming the national decrease of 2.3 percent.

The dollar value of total building activity (excluding Arkansas) for the 12 months ending December 1982 declined 8.7 percent in the Mid-South compared with the same period in 1981. Alabama was the hardest hit with declines across-the-board. Mississippi registered mixed results, gaining 11.7 percent in residential activity but declining 10.6 percent in nonresidential building. Both Tennessee and Louisiana registered positive gains across-the-board.

Mortgage loan activity by Mid-South savings and loans totaled $2,131.2 million in 1982, an increase of 4.9 percent

Table 4
PERCENTAGE CHANGE IN BUILDING ACTIVITY FOR 1982 COMPARED TO 1981

CONSTRUCTION[1] December 1982	United States	Alabama	Arkansas	Louisiana	Mississippi	Tennessee
Total Building						
Percent Change Year Ago	- 7.4	-13.2	N.A.	+ 7.7	- 0.3	+ 7.2
Residential Building						
Percent Change Year Ago	- 1.5	-19.3	N.A.	+ 8.1	+11.7	+18.1
Non-Residential Building						
Percent Change Year Ago	-12.0	- 9.3	N.A.	+ 7.4	-10.6	+ 0.6
Total Dwelling Unit Permits						
Percent Change Year Ago	+ 1.6	-15.6	N.A.	+ 8.9	+ 9.6	+26.1

[1] Twelve-month cumulative rate.

[2] Non-Residential data exclude the cost of construction for publicly-owned buildings.

Source: Federal Reserve Bank of Atlanta from data supplied by the Bureau of the Census.

over 1981. Three of the Mid-South states reported declines of 18.0 percent or more, while Arkansas and Louisiana managed gains of 75.6 percent and 4.9 percent, respectively. Net saving flow activity reported by the savings and loans totaled $1,744.1 million in 1982, up 180.4 percent from the depressed levels of 1981.

Total deposits at commercial banks in the Mid-South increased 10.3 percent from a year ago, outperforming the national increase of 9.8 percent. Time deposits continued to register the most spectacular gains, up 13.4 percent from last December, while savings deposits managed a moderate gain of 5.2 percent.

Table 5
1982 SAVINGS AND LOAN ACTIVITY AND
PERCENTAGE CHANGES FROM 1981

SAVINGS AND LOAN ACTIVITY	Alabama	Arkansas	Louisiana	Mississippi	Tennessee[1]
Mortgage Loans Made (millions)	$223.8	$571.2	$ 888.4	$139.0	$308.9
Percent Change Year Ago	-18.1	+75.6	+ 4.9	-29.3	-20.6
Net Savings Flow (millions)[2]	$149.6	$284.5	$1,004.1	$111.4	$194.5
Percent Change Year Ago	+255.3	+563.2	+53.3	+239.6	+119.5

[1] Figures are for total loans made.

[2] Net savings flow equals new savings received plus dividends credited minus savings withdrawn.

Source: Federal Home Loan Banks of Little Rock, Cincinnati, and Atlanta.

Table 6
BANKING: MEMBER BANKS AS OF 12/29/82: PERCENTAGE
CHANGES FROM COMPARABLE 1981 PERIOD

FINANCE	United States	Mid-South States	Alabama	Arkansas	Louisiana	Mississippi	Tennessee
Total Deposits	+ 9.8	+10.3	+ 6.5	+ 9.1	+10.5	+ 9.9	+11.1
Demand Deposits	- 1.1	- 0.5	+ 2.3	+ 6.5	- 4.2	- 0.5	- 1.5
Time Deposits	+13.2	+13.4	+ 6.3	+11.1	+15.6	+11.3	+13.6
Savings Deposits	+ 5.9	+ 5.2	+ 5.8	+ 6.6	+ 5.0	+ 5.5	+ 5.3

Source: Federal Reserve Bank of St. Louis and the Federal Reserve Bank of Atlanta.

waterway, and Mississippi is getting $1.4 million for the Tombigbee River and it tributaries. No new construction projects are listed for Tennessee.

Finance

Total commercial bank deposits in the nation rose 11.1 percent above last January, with savings deposits increasing 47.4 percent. Most of the Mid-South states experienced similar increases in both total deposits and savings accounts.

Mortgage loans made by Mid-South savings and loans registered substantial gains from their levels a year ago. Even more spectacular, however, was the substantial turnaround registered in net savings flow activity for Mid-South savings and loans.

LABOR January 1983	United States	Mid-South States				
		Alabama	Arkansas	Louisiana	Mississippi	Tennessee
Civilian Labor Force	109,779,000	1,728,700	997,900	1,811,800	1,031,900	2,111,500
Percent Change Year Ago	+ 1.6	+ 4.5	+ 1.4	- 0.3	+ 0.3	+ 0.7
Unemployed	12,517,000	286,900	110,900	203,900	125,700	288,400
Percent Change Year Ago	+21.6	+27.3	+ 0.8	+19.9	+12.3	+12.2
Unemployment Rate						
1983	11.4	16.6	11.1	11.3	12.2	13.7
1982	8.6	13.6	11.2	9.4	10.9	12.3
Non-Agricultural Wage & Salary Employees	88,874,000*	1,301,800	710,000	1,587,600	779,700	1,639,000
Percent Change Year Ago	- 1.7	- 0.2	- 0.1	- 1.6	- 1.3	- 2.8
Manufacturing Employment	18,158,000*	324,400	191,100	195,000	195,600	453,500
Percent Change Year Ago	- 6.9	+ 5.1	- 2.8	- 8.6	- 4.8	- 5.8
Non-Manufacturing Employment	70,716.000*	977,400	518,900	1,392,600	584,100	1,185,500
Percent Change Year Ago	- 0.3	+ 1.5	+ 0.9	- 0.5	- 0.1	- 1.6
Average Weekly Earnings of Production Workers in Manufacturing	$340.17	$296.96	$270.48	$383.53	$258.72	$293.09
Percent Change Year Ago	+ 8.9	+ 2.2	+ 4.8	+ 2.5	+ 7.3	+ 6.9
Average Weekly Hours of Production Workers in Manufacturing	39.1	39.7	39.2	42.1	39.2	39.5
Percent Change Year Ago	+ 5.4	- 1.2	- 0.7	- 0.9	+ 1.3	- 0.7
Average Hourly Earnings of Production Workers in Manufacturing	$8.70	$7.48	$6.90	$9.11	$6.60	$7.42
Percent Change Year Ago	+ 3.3	+ 3.5	+ 5.6	+ 3.5	+ 5.9	+ 7.7

*Seasonally adjusted.

Source: Departments of Employment Security and Survey of Current Business.

CONSTRUCTION[1] January 1983	United States	Alabama	Arkansas	Louisiana	Mississippi	Tennessee
Total Building Percent Change Year Ago	- 5.2	- 11.3	N.A.	+ 16.3	+ 7.9	+ 10.6
Residential Building Percent Change Year Ago	+ 4.4	- 14.8	N.A.	+ 14.1	+ 25.6	+ 28.5
Non-Residential Building Percent Change Year Ago	-12.6	- 9.0	N.A.	+ 17.8	- 6.8	+ 0.2
Total Dwelling Unit Percent Change Year Ago	+ 7.9	- 12.1	N.A.	+ 15.5	+ 18.0	+ 33.9

[1] Twelve-month cumulative rate.

[2] Non-residential data exclude the cost of construction for publicly-owned buildings.

Source: Federal Reserve Bank of Atlanta from data supplied by the Bureau of Census.

FINANCE	United States	Mid-South States	Alabama	Arkansas	Louisiana	Mississippi	Tennessee
Member Banks as of 1/5/83 Percent Change from Comparable Date 1982:							
Total Deposits	+11.1	+13.7	+12.4	+24.4	+11.9	+10.6	+11.3
Demand Deposits	- 1.5	- 0.8	+ 2.7	- 2.7	- 5.0	- 2.5	- 1.3
Time Deposits	+ 6.2	+ 8.2	+ 4.4	+33.1	+12.9	+ 7.1	+ 7.8
Savings Deposits	+47.4	+60.6	+36.2	+22.6	+33.8	+63.3	+44.3

Source: Federal Reserve Bank of St. Louis and the Federal Reserve Bank of Atlanta.

SAVINGS AND LOAN ACTIVITY January 1983	Alabama	Arkansas	Louisiana	Mississippi	Tennessee[1]
Mortgage Loans Made (millions)		$ 70.3	$ 84.7	$ 19.9	$ 47.4
Percent Change Year Ago	N.A.	+ 223.9	+ 99.3	+282.7	+235.8
Percent Change Year-to-Date	N.A.	N.A.	N.A.	N.A.	N.A.
Net Savings Flow (millions)[2]	N.A.	$ 160.8	$ 181.5	$ 26.5	$ 97.7
Percent Change Year Ago	N.A.	+2693.5	+432.3	+762.5	+1097.4
Percent Change Year-to-Date	N.A.	N.A.	N.A.	N.A.	N.A.

[1] Figures are for total loans made.

[2] Net savings flow equals new savings received plus dividends credited minus savings withdrawn.

Source: Federal Home Loan Banks of Little Rock, Cincinnati, and Atlanta.

TENNESSEE ECONOMY

The Tennessee economy enters 1983 struggling with the second highest unemployment rate in the Mid-South at 13.7 percent. This translates into 288,400 unemployed workers, a 12.2 percent increase over January 1982. Total non-agricultural employment stood at 1,639,000, a drop of 2.8 percent from a year ago. Manufacturing employment continues to shoulder the brunt of the unemployment, with 5.8 percent fewer jobs than this time last year. The key to this sector is increased consumer spending for durable goods and, because Tennessee's capital stock is newer, it should be able to outperform most non-Southern manufacturing states as recovery begins.

Total personal income grew 5.2 percent from third quarter 1981 to third quarter 1982, second best in the Mid-South. Much of the increase is attributable to an improving construction sector. The value of total building activity increased 10.6 percent for the twelve months ending January 1983 compared with the same period in 1982. Residential building activity was 28.5 percent above the levels of a year ago, registering the best gain in the Mid-South.

Sales tax collections totaled $198.8 million for the first two months of 1983, an increase of 8.0 percent over the same period in 1982. This is a welcome improvement, since the recession and an unresponsive tax system had curtailed tax revenue collections below expectations for most of 1982. However, Tennessee's government sector remains a major concern for an improving economy. Usually countercylical, Tennessee's government sector has reversed that pattern. In the 1973-75 recession, seasonally adjusted government employment grew 11.6 percent, whereas it has fallen 8.7 percent during the current recession. Moreover, a recent report by the Federal Reserve Bank of Atlanta suggested that "whatever measures the State undertakes to increase revenues and decrease costs in the short-run, the long-run opportunity costs may be greater." Those opportunity costs revolve around the deterioration of Tennessee's infrastructure and the prospects for a more highly trained work force by increased educational expenditures. These types of expenditures are necessary if Tennessee wishes to attract an advanced technology industry. A step in that direction was taken recently when the Appalachian Regional Commission made a grant of $1.2 million to develop a hi-tech corridor along the Pellissippi Parkway between Oak Ridge and the Knoxville area. Plans include a new campus for the State Technical Institute of Knoxville and a business technology center to help companies reach production stage.

Tennessee's farm price index stood at 128 in February 1983, down three index points from a year ago. Farm incomes remain low due to weak demand and high yields. Lower feed costs in 1982 bode well for livestock farmers in 1983, while crop surpluses, especially soybean, need to be worked down before any improvement can be seen in commodity prices.

Finally, according to recent reports by the Conference Board, Tennessee ranked 10th in the nation in terms of the number of foreign investments (building, expanding, or acquiring) undertaken between 1971 and 1982.

The rate is presently 1 cent per gallon on volatile substances produced from petroleum, natural gas, oil shales, or coal or substitutes for those products. Collections are distributed 98.0 percent to the Highway Fund and 2.0 percent to the General Fund. However, the annual amount of $12,017,000 is distributed monthly to local governments and must be spent solely for streets and roads.

Income Tax: The Tennessee income tax was enacted in 1929 and is levied on income from stocks and bonds. The present 6.0 percent tax rate applies only to dividends on stocks and interest on bonds received by individuals and partnerships. The rate is reduced to 4.0 percent on dividends from corporations with more than 75.0 percent of their property subject to the Tennessee *ad valorem* tax. Revenue from this tax is apportioned 30.0 percent to the counties and municipalities and 70.0 percent to the General Fund.

Inheritance, Estate and Gift Taxes: Tennessee's first inheritance tax was passed in 1891. The rate was initially $5 per $100 on the value of all property in the state which went to the collateral heirs. All property, real and personal, is appraised at its full value at the date of death of the decedent.

The rate and base are divided into two classes. Class A includes husband, wife, child, lineal ancestors and decendents, legally adopted child, brother, sister, and stepchild. Class A transfers are allowed a $120,000 exemption from the net estate in arriving at the net taxable Class A estate. The tax rates on the net taxable estate vary from 5.5 percent on the first $40,000 to 9.5 percent on any excess above $440,000.

Class B provides a $10,000 exemption to any relative, person, association, or corporation not specifically designated in Class A. The tax rates vary from 6.5 percent on the first $50,000 to 16.0 percent on any excess over $200,000. That portion of the estate passing to a surviving spouse is deducted from the value of the gross estate. The maximum deduction is the greater of $250,000 or one-half of the adjusted gross estate.

Mixed Drink Tax: The mixed drink tax, enacted by the General Assembly in 1967, was originally applicable only to the state's four largest counties. It is a combination of two separate tax levies, one of which is an annual licensing requirement. In addition, the state levies a gross receipts tax of 15.0 percent on the sales price of all alcoholic beverages consumed on the premises of a licensed establishment. The revenue received from the license fees goes entirely to the General Fund, while gross receipts collections are apportioned as follows: 50.0 percent to the General Fund, earmarked for education, and 50.0 percent to the county or city in which sales were made.

Motor Vehicle Fuel Tax: The motor vehicle fuel tax was enacted in 1941 as the use of diesel fuel became increasingly popular. The original rate of 7 cents per gallon was increased to 8 cents per gallon in 1963, and to 12 cents per gallon effective July 1981. The tax is imposed on the sale of diesel fuel by any person within the state. These proceeds are apportioned to the various funds as follows: Highway Fund, 61.25 percent; General Fund, 1.62 percent; counties, 24.75 percent for their highway funds; and municipalities, 12.38 percent.

Motor Vehicle Registration Fees: Motor vehicles were first required to be registered in 1905. The current registration fees are for the different classes of motor vehicles.

A. Registration Fees of Personal Use Vehicles (7 classes)

Class A:	Motorcycles	$ 8.75
Class B:	Commercial 3-wheel motorcycles	$ 20.00
Class C:	Passenger motor vehicles	$ 17.75
Class D:	Rented trailers and house trailers not over 8′ in width and 20′ in length	$ 8.50
Class E:	Antique vehicles	$ 8.50
Class F:	Mobile Homes or house trailers	
	not over 8′ wide and 35′ long	$ 18.00
	not over 8′ wide and 50′ long	$ 24.00
	not over 8′ wide but over 50′ long	$ 30.00
	not over 10′ wide and 35′ long	$ 30.00
	not over 10′ wide and 50′ long	$ 36.00
	not over 10′ wide and over 50′ long	$ 42.00
	over 10′ wide and whatever length	$ 50.00
Class G:	Private buses (not for hire)	$180.00

B. Registration Fees of Freight Motor Vehicles (11 classes)

C. Public Household Goods Carriers

D. Combined Farm and Limited Private Trucks (10 classes)

E. Miscellaneous Classes

F. Freight Trailers and Semitrailers

Motor Vehicle Title Registration Fees: The Motor Vehicle Title Registration Law was enacted in 1951 to discourage theft and to provide a method of noting and discharging liens on certificates of titles. Fees were levied to offset the costs incurred in administering the law. Title fees are due either when an application for title is made or when a change in an existing title is requested. All fees are apportioned to the General Fund.

Privilege Taxes: Tennessee's privilege tax now consists primarily of receipts derived from realty transfers and mortgages, deeds of trusts, and other instruments offered for recording and litigation activities. The realty transfer tax applies to instruments involving transfers of realty interests at the time when documents are offered for recording. The tax is paid at the rate of 26 cents per $100 by the grantee or transferee of the interest in real estate as shown on the instrument evidencing the transfer or on the value of the property, whichever is greater. The mortgage tax is levied when the instruments involving an indebtedness are recorded. This involves mortgages, deeds of trust, conditional sales contracts, and financing statements. The rate of tax is 10 cents per $100 on any amount over the first $2,000.

Litigation taxes are imposed upon persons making use of the judicial system of the state. They are collected by judicial clerks from the plaintiff in a civil suit and in a criminal case from the defendent upon a finding of guilt. Most of these taxes are earmarked for retirement purposes, drivers education, and compensation of crime victims. The remainder goes to the General Fund.

Gross Receipts Taxes: Since 1937, there have been numerous alterations in Tennessee's gross receipts taxes, and little uniformity exists at present in either exemptions or rates. Tax rates vary from 1.0 percent on theaters up to 15.0 percent on setups sold at mixing bars. The largest single component of reported receipts in this general category involves payments from TVA in-lieu-of-tax payments to Tennessee. Gross receipts taxes are apportioned to the General Fund. TVA payments are shared between the General Fund and city and county governments.

Sales and Use Tax: First imposed in 1947, the retail sales and use tax immediately became the state's largest single revenue source. The major purpose in enacting the sales tax was to provide funds for state and county education programs, and the bulk of revenue collected has been devoted to this purpose.

At present, the sales and use tax rate is 4.5 percent and is applied to the sale, use, consumption, distribution, lease, or rental of tangible personal property and a few selected services. Farm and manufacturing machinery and air and water pollution control devices used by manufacturers were previously taxed at the rate of 1.0 percent. However, this rate is being phased out over a period of three years, ending July 1, 1983. In addition, a 1.0 percent rate is levied on water and a 1.5 percent rate on gas, fuel oil, electricity, coal, and other energy fuels when sold or used in manufacturing. A 1.5 percent rate applies to residential use of electricity and energy fuels, while commercial users other than manufacturers pay 4.5 percent. Approximately 93.0 percent of the revenue from this tax goes to the General Fund; the remainder goes to municipalities and the Sinking Fund.

Severance Taxes: A tax of 1.5 percent of the selling price of the gas and oil removed from the ground was established in 1979 and increased to 3.0 percent in 1982. One-third of revenues collected is returned to the county from which the product was severed, and the remainder is allocated to the General Fund.

A severance tax on the total value of all coal products mined in Tennessee was first imposed in 1972. The rate is set at 29 cents per ton for 1982, with increases to 32 cents per ton scheduled to take effect July 1, 1983, and 35 cents per ton effective July 1, 1984. All revenues, less 3.0 percent, and all interest and penalties collected are returned to the county from which the coal products were severed, with the exception that revenues generated from tax rates in excess of 20 cents per ton go to the state's General Fund.

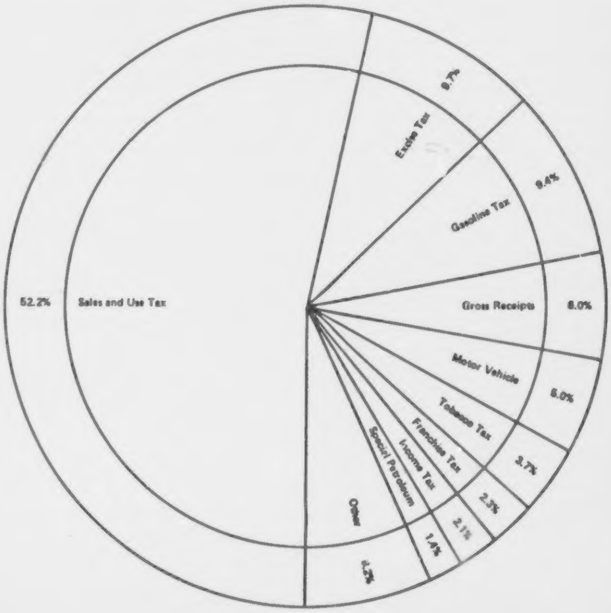
Tobacco Taxes: First enacted in Tennessee in 1925 as a two-year emergency measure, tobacco taxes both provide revenue for public schools and permit reductions in the state property tax. The tax rate on cigarettes is 6 1/2 mills per cigarette, or 13 cents per package of 20 cigarettes. The tax rate on all other tobacco products is 6.0 percent of the wholesale cost price. In addition, the retail dealer's license fee is $5 for each store, vending machine, vehicle, or location where sales are made directly to the consumer. The license fee for tobacco distributors is $10 for each secondary wholesale location; for wholesale dealers and jobbers, the fee is $20 for each separate sales warehouse.

The cigarette tax is collected using tax stamps issued and sold by the Commissioner of Revenue. Cigarette distributors receive a discount on their tax payments to cover the cost of fastening the stamps to the cigarette packages. The discount decreases from a top rate of 2.75 percent down to the lowest rate of 1.75 percent as the quantity of stamps purchased rises. The revenue from these sources is apportioned to the General Fund, with 96.0 percent earmarked for educational uses.

The Role of Each Tax In Contributing To State Revenues

Figure 1 shows the importance of each tax in fiscal year 1982. Of the taxes considered here, the sales tax accounted for more than half (52.25 percent) of the state's revenues in 1982. This tax alone represented $1,112,636,443 of Tennessee's $2,129,478,929 total revenues. Next in importance was the excise tax. It accounted for ($206,835,134), or 9.71 percent of revenues. Third, at 9.47 percent, was the gasoline tax which brought in ($201,167,647). The gross receipts tax amounted to $126,834,918, which represented 5.96 percent of total collections; while the motor vehicle tax accounted for $105,635,684, or 4.96 percent of total revenues.

FIGURE 1
SOURCES OF REVENUE
FISCAL YEAR 1982



The tobacco tax produced 3.68 percent of 1982 revenues. In dollar terms this represented $78,441,904. The franchise tax brought in $49,511,249, approximately 2.32 percent of the state government's income. Representing about 2.31 percent of total revenues was the motor fuel tax. Total dollars collected from this tax were $49,123,496 in 1982. An income tax amounted to $44,468,965 or 2.09 percent of the state's total. Alcoholic beverage tax revenues—$30,016,280—accounted for 1.41 percent of total revenues, while the special petroleum tax represented 1.40 percent and produced $29,854,670 in 1982.

The inheritance tax and the privilege tax accounted for 1.34 percent and 1.32 percent, respectively, of state revenues. The inheritance tax brought in $28,638,832, while the privilege tax generated $28,042,942.

A mixed drink tax accounted for 0.76 percent of revenues, bringing in $16,115,822, while the beer tax generated $11,952,357 or 0.56 percent of the total. Approximately 0.28 percent of revenues were produced by the business tax which brought the state $5,890,204. Finally, motor vehicle title taxes were $3,147,508, about 0.15 percent of the total. Only $644,147 was generated by filing fees. This sum represented 0.03 percent of the total tax revenues.

Summary and Conclusions

The above analysis suggests that Tennessee has a fairly diverse revenue base which relies heavily on consumption based taxes. These taxes are widely regarded as regressive, and as such they fall more heavily on the poor than on the rich. While the income tax is levied on interest on stocks and dividends, this tends to place a heavy burden on persons who are asset rich but earnings poor, particularly the elderly. The inheritance tax, which is also potentially progressive, represents a minor part of state revenues.

Viewed in total, the existing structure provides a viable means of providing state revenues. However, the structure has been subject to the criticisms that it falls heavily on business and that it fails to provide adequate revenues to meet state needs.

SEXUAL HARASSMENT: DO COLLEGE OF BUSINESS EDUCATED EMPLOYEES PERCEIVE IT DIFFERENTLY BECAUSE OF SEX AND JOB LEVEL?

*Maynard M. Dolecheck and Carolyn C. Dolecheck**

Several studies in recent years indicate that sexual harassment of women by men in the workplace may occur more often and to a greater extent that anyone thinks. The authors' previous research determined the emotional feelings of sexually harassed women to be embarrassment, intimidation, helplessness, and anger.[1] Women experiencing such feelings often suffer serious psychological problems requiring medical attention as reported in several studies, such as the one at the Work Clinic at the University of California Hospital in San Francisco.[2] More frequently, however, such emotional problems lead to increased absenteeism, a general reduction in output while on the job, and even resignation as a last resort.

Furthermore, adoption in November 1980 of the EEOC Guidelines, which define actions constituting sexual harassment and clarify an organization's liability for such actions, has added urgency for information concerning the seriousness of the problem.[3]

Most studies have been limited to asking employed women whether they had encountered sexual harassment. Few studies have focused on perceptions of harassment by sex and by job level within an organization. Nelson et al, asked both male and female subjects to evaluate eleven different situations involving activities that probably could be classified as harassment. The overall rankings of the situations as to the appropriateness of the situation revealed wide agreement between the sexes about the order of disapproval of various situations. The only specific situation which showed a significantly greater disapproval rating by women than by men was related to off-color jokes.[4]

Collins and Blodgett used four vignettes and asked questions concerning them of both men and women. Also, the men and women responded to a series of other questions concerning harassment. Their conclusions were: (1) "Men and women generally agree in theory on what sexual harassment is but disagree on how often it occurs; and (2) top management appears isolated from occurrences of harassment, and middle managers are somewhat less aware of misconduct than lower-level managers."[5]

Purpose and Design of Study

People often have differing viewpoints because of their experiences, sex, educational level, job, age, and/or other factors. Since sexual harassment is a topic which seems to elicit widely differing opinions, the researchers sought to compare sexual harassment perceptions of employed males and females of similar backgrounds, particularly education. Therefore, in July 1982 a questionnaire was sent to 600 males and 600 females who had been graduated during a sixteen-year period (1966-1981) from the College of Business Administration (an AACSB accredited school) at Northeast Louisiana University, Monroe. A 30.0 percent response rate was obtained.

Since NLU is a regional university, students come from the local area and thus have similar cultural backgrounds and experiences. Furthermore, 92.0 percent of the respondents are now employed in the South and Southwest. Their ages differed slightly; the median age of males was 30.8 years, while that of the female respondents was 27.4 years. This difference can be explained in that relatively few women graduated with business degrees during the early part of the sixteen-year period.

Polling this fairly homogeneous group, the researchers through a series of related questions proposed to compare responses by sex and job level of the respondents to three questions: (1) Is sexual harassment a serious problem in organizations? (2) Should women themselves be able to prevent and/or handle harassment? (3) Are organizations attempting to prevent harassment of employees?

Respondents were asked to mark "Agree" or "Disagree" or "Yes" or "No" to seveal statements and/or questions concerning sexual harassment. The responses were classified by sex and job level. Job level was divided into five classifications—top management, middle management, first-line supervisor, staff/technical, and sales. Staff/technical included a multitude of jobs that required no supervisory responsibilities such as accountant, programmer, and marketing research analyst. The sales classification required no supervisory responsibilities; but from past research, the authors found opinions of sales personnel (most are on the road) somewhat different from other nonsupervisory personnel.

Since percentages of males and females employed at the various job levels were quite different, it was necessary to separately classify male responses by job level and female responses by job level. The chi-square test was used for testing significance.

Sexual harassment was defined for the respondents as "unwanted and unreciprocated sexual advances, remarks, touching, or leering of a male toward a female in a work

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**The authors are, respectively, Professor, Department of Management/Marketing, and Assistant Professor, Department of Office Administration, Northeast Louisiana University, Monroe, Louisiana.*

environment which interferes with the woman's work performance and creates an intimidating, hostile, or offensive working environment." The definition is consistent with EEOC guidelines.

Research Findings

The responses discussed and analyzed in this section are presented to compare perceptions of employed business-educated men and women at varying organizational levels as to whether harassment is a serious employment problem, whether women should be able to control the situation, and whether organizations are doing anything to prevent harassment of their employees.

Is Harassment a Serious Problem?

While the respondents were not specifically asked if harassment was a serious problem in their organizations, they were asked to respond to three other statements, the responses to which would indicate their opinions of the seriousness of sexual harassment. The first statement to which the respondents responded "Agree" or "Disagree" was "The amount of sexual harassment at work is greatly exaggerated." Reactions to the statement classified by type of job and sex are shown in Tables 1 and 2.

Table 1
MALE RESPONSES TO STATEMENT:
"SEXUAL HARASSMENT IS GREATLY EXAGGERATED"
(Responses Categorized by Job Level)
$p < .05$

	Job Level					
Response of Males	Top Mgt.	Middle Mgt.	First-Line Supervisor	Staff/ Technical	Sales	Total
Agree	82.8%	83.0%	83.3%	59.2%	84.6%	76.3%
Disagree	17.2	17.0	16.7	40.8	15.4	23.7
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
	(29)	(47)	(18)	(49)	(26)	(169)

Table 2
FEMALE RESPONSES TO STATEMENT:
"SEXUAL HARASSMENT IS GREATLY EXAGGERATED"
(Responses Categorized by Job Level)
$p < .10$

	Job Level				
Responses of Females	Middle Mgt.* or Above	First-Line Supervisor	Staff/ Technical	Sales	Total
Agree	50.0%	59.1%	32.0%	50.0%	39.6%
Disagree	50.0	40.9	68.0	50.0	60.4
	100.0%	100.0%	100.0%	100.0%	100.0%
	(26)	(22)	(103)	(8)	(159)

*Top and middle management are combined as only six women respondents were top managers.

By observing the total columns in Tables 1 and 2, one can see that 76.3 percent of the male respondents compared to only 39.6 percent of the female respondents agreed with the statement. Although not shown in the tables, the difference in responses by sex was significant. Furthermore, as can be seen in Tables 1 and 2, a significant difference in response by job level existed. Respondents in staff/technical jobs (both male and female) were less likely to agree that harassment was exaggerated when compared with managers at all levels. Apparently managers are isolated from the problem and thus feel that sexual harassment is greatly exaggerated. Two statements from respondents (the first from a female in a staff/technical position and the second from a male in a middle-management job) illustrated typical feelings:

> Sexual harassment still exists and is a serious problem. The fact is that some men don't feel comfortable working with women on an equal basis; they seem to use sexual jokes and comments in an attempt to appear more "with it" or "in charge."
>
> Even females frequently make excuses to work with or be near males and to touch accidently when possible. So I feel that so-called sexual harassment is usually little more than good natured "lust." Even former president Jimmy Carter "lusted in his heart."

Since a previous study by the authors revealed that quitting is the last resort solution to an harassment problem,[6] the respondents were asked a second question: "Do you know of anyone in the past three years who has quit your company due to sexual harassment?" Of all respondents, 8.0 percent answered "Yes" to the question. No significant differences by sex or job level were found; however, none of the 30 male respondents who were top managers knew of anyone who had quit due to harassment.

While only 8.0 percent of all respondents knew of anyone who had quit their company in the past three years due to harassment, this finding is likely to indicate a serious problem. Quitting a job is usually a last resort solution, especially in the early 1980s when jobs are harder to find because of the high unemployment rate. Furthermore, since harassment is a private and embarrassing situation, other employees are not likely to know the true reason for an individual's quitting. This statement is confirmed by Somers and Clementson-Mohr who declare, "Though unstated in most cases, this [sexual harassment] may be the primary reason that most women leave their jobs."[7]

A third statement which would lend some light on the respondents' feelings about the seriousness of harassment in their firms was then posed. The respondents were to "Agree" or "Disagree" with the statement, "Most women when harassed do not complain because they fear retaliation of some form." A greater percentage of the women (86.7 percent) compared with the men (72.1 percent) agreed with the statement. While this finding showed a significant difference by sex, no significant difference in responses was found by job level. However, the most important finding was the high percentage of both sexes who agreed that women do not complain because of fear of retaliation. Such a finding indicates that organizations are not providing administrative controls to prevent retaliation. An example was the comment by a woman whose company had a grievance procedure pertaining to sexual harassment.

> A woman can't control whether she will be working with the harasser in the future or even if he will be reprimanded. Such a lack of control could lead to a quite frustrating situation. Furthermore, I would fear complaining because of lack of faith in the system which is to handle the situation. In fact, more harassment could result.

Can Women Themselves Control Harassment?

Even when business people admit that harassment occurs on the job, they often place the blame on the victims by statements such as: (1) "Women cause harassment and thus shouldn't expect their companies to bear the responsibility"; and (2) "If harassment occurs, a woman should be able to handle the problem herself."

To determine if any differences existed in the perceptions of men and women by job level about the question of women controlling the harassment situation, all respondents were asked to "Agree" or "Disagree" with two statements. The first statement was: "If a woman dresses and behaves properly, she *will not* be the target of unwanted sexual approaches at work." Although no significant differences were found by job level, a significant difference in response by sex was found; 31.1 percent of the men and 17.3 percent of the women agreed with the statement.

Thus, nearly one-third of the men "Agree" that women can control sexual advances by their dress and behavior, while only one-sixth of the women indicated this belief. The following comments illustrate the two contrasting points of view: A woman in a staff/technical position stated:

> I thought harassment was something of the past; however, the more time on the job, the worse it is. Of course the majority of men are businesslike, but the few "others" can spoil a workplace. I am happily married, dress properly, and do not promote snide remarks—yet I get them. Sometimes I wish I were terribly ugly and maybe then I would be treated professionally.

On the other hand, a male middle manager commented:

> I have observed that most sexual harassment against females is due to inappropriate dress and actions. Don't show it if you don't want it seen. Also, I find that females who dress like ladies are treated as ladies; those who dress like streetwalkers are treated as such . . . .

The second statement to which the respondents reacted stated: "A smart woman employee ought to be able to handle sexual harassment." A significant difference in responses was noted by sex; 68.2 percent of the males agreed, while 57.4 percent of the females agreed. Furthermore, there was a significant difference in responses for males by job level; a higher percentage of top and middle managers were in agreement when compared with first-line supervisors and staff/technical employees, as shown in Table 3. The same finding tends to be true for women as shown in Table 4; however, the differences were not significant. A comment by one woman descriptively illustrated a minority viewpoint that a woman should be able to handle a sexual harassment problem by herself. (Note, however, that the woman had not experienced harassment on the job.)

> While I have not experienced any sexual harassment in my job, I *imagine* I could handle the problem. (Imaginary conversations: "I'll tell your wife." "I'll tell your boss." "I will tell every female worker in our office that you are a lecherous old man." "I'll put up your picture on the office bulletin board captioned SEXUAL HARASSER OF WOMEN." "I'll tell *my* husband, so leave me alone.")

While the researchers cannot explain the finding, nearly three-fourths of all men and women in sales occupations "Agree" that women should be able to handle sexual advances.

Table 3

MALE RESPONSES TO STATEMENT:
"A SMART WOMAN EMPLOYEE OUGHT TO BE ABLE TO HANDLE SEXUAL HARASSMENT"
(Responses Categorized by Job Level)
p < .05

	Job Level					
Response of Males	Top Mgt.	Middle Mgt.	First-Line Supervisor	Staff/ Technical	Sales	Total
Agree	86.7%	74.5%	55.0%	55.8%	70.4%	68.2%
Disagree	13.3	25.5	45.0	44.2	29.6	31.8
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
	(30)	(47)	(20)	(52)	(27)	(176)

Table 4

FEMALE RESPONSES TO STATEMENT:
"A SMART WOMAN EMPLOYEE OUGHT TO BE ABLE TO HANDLE SEXUAL HARASSMENT"
(Responses Categorized by Job Level)
p = .21

	Job Level				
Response of Females	Middle Mgt.* or Above	First-Line Supervisor	Staff/ Technical	Sales	Total
Agree	70.4%	58.3%	52.0%	77.8%	57.4%
Disagree	29.6	41.7	48.0	22.2	42.6
	100.0%	100.0%	100.0%	100.0%	100.0%
	(27)	(24)	(102)	(9)	(162)

*Top and middle management are combined as only six women respondents were top managers.

Are Organizations Attempting to Control Harassment?

If an organization is committed to combatting sexual harassment problems, it will establish a policy statement and procedure for reviewing complaints as a first step. Therefore, respondents to the questionnaire were asked, "Does your organization have a policy statement prohibiting sexual harassment and a formal procedure for reviewing harassment complaints?"

Only 35.3 percent of all respondents reported being employed by companies having such a policy statement and procedures. As might be expected, there were no differences by sex. No differences by job level for women were revealed; however, there was a significant difference when males were classified by job title. Only 6.7 percent of the top male managers were employed in organizations having such a policy statement and procedures. A possible reason for this finding was that such policies and procedures are initiated by top management, and the top male managers in this study evidently believed such a policy was unnecessary, as 83.0 percent of the men thought sexual harassment was greatly exaggerated; 86.7 percent believed that a woman ought to be able to handle sexual harassment herself; and none knew of anyone who had quit their organization due to harassment.

In defense of his company's lack of a policy statement, one male top manager stated: "Having a policy would just invite trouble." While this statement could posibly be true, the Center for Women's Policy Studies in Washington, D.C., reports: "Complaints by employees may increase at first; but as policies are maintained, complaints will begin to decline."[8]

Summary and Implications

By examining the perceptions of the respondents by their sex and their job levels to several statements and questions, one can determine that harassment is perceived as a more serious problem by women than men and that men in higher job levels are unaware of a problem. While only 8.0 percent of both men and women knew of anyone who had quit their firm recently because of harassment, none of the male top managers knew of anyone's quitting because of harassment. These findings are consistent with Collins and Blodgett's findings about top management's being isolated from the problem.[9] While a higher percentage of female than male respondents believed that harassed employees feared retaliation if they filed a complaint, well over two-thirds of both sexes agreed that this fear probably prevented harassed personnel from filing a complaint. As a result of few complaints being filed, the extent of the problem may not be evident to men in top management.

Men and women differed significantly in their beliefs about whether women can control harassment themselves. While job level made no difference in their perceptions about women controlling harassment by the way they dress and act, the data revealing that men in higher-level positions believed that smart women ought to be able to handle an harassment situation were significant. Women in higher-level jobs also tended to agree. One can perhaps theorize that business personnel in higher-level jobs with authority over others feel secure with their power that they could handle a situation and therefore believe others should be able to do the same. Yet employees (both men and women) at the lower levels have more likely witnessed or know of an harassment situation that the employee could not control.

Since only one-third of all respondents were employed by organizations having a policy statement forbidding harassment and procedures for reviewing complaints, most organizations are evidently not committed to combatting sexual harassment. As most top managers are male who believe harassment is exaggerated and that women should be able to control any harassment situation, many of these organizations are not likely to establish any policies or procedures until serious problems arise and more women move to top-management levels.

Perhaps with these research findings, top-level business executives will realize that harassment likely exists to some extent in their firms and that they are isolated from harassment situations. Perhaps they will examine carefully any possible harassment problems in their firms and establish a policy statement and procedures for reporting any violations. Just because they don't see it, doesn't mean harassment doesn't exist.

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[2] James C. Renick, "Sexual Harassment at Work: Why It Happens, What to Do About It," *Personnel Journal*, August 1980, pp. 658-662.

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[4] James A. Nelson and others, "Sexual Harassment: An Exploratory Study of Its Definitions and Differential Perceptions," *Proceedings of the Southwest Region AIDS*, New Orleans, Louisiana, March 5-6, 1981, pp. 31-33.

[5] Eliza Collins and Timothy Blodgett, "Sexual Harassment . . . Some See It . . . Some Won't," *Harvard Business Review*, March/April 1981, pp. 77-95.

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[7] Patricia Somers and Judith Clemontson-Mohr, "Sexual Extortion in the Workplace," *The Personnel Administrator*, April 1979, pp. 23-28.

[8] Center for Women Policy Studies, *Harassment and Discrimination in Employment* (Washington, D.C.: Center for Women Policy Studies, 1981), p. 1.

[9] Collins and Blodgett.

WOMEN SUPERVISORS AND EFFECTIVE DELEGATION

*Fred R. David**

Survey trends indicate that women occupy one-fourth of all managerial and administrative jobs in private industry. Propelled by affirmative-action laws, the feminist movement, and the rising consciousness of organizations, women have come a long way in business fields and are likely to move more rapidly in the future into higher corporate positions. As women are moving into managerial jobs at increasing rates, their effectiveness as supervisors is important for continued career growth. Recent research studies have shown that performance differences between men and women are not due to anti-female bias, but are instead results of differences in behavioral characteristics. That is, women managers "manage" differently than men managers. Through increased awareness of these differences women supervisors can improve their managerial effectiveness. The purpose of this article is to provide this awareness and to suggest specific areas for improvement.

Looking at Performance

Research studies have shown that men are more effective than women in areas that indicate better performance. For example, in a recent study [1] that compared 110 male bank managers with 111 female bank managers, men were found to be more effective than women on dependability, technical competence, communication skills, and quality of work. No differences were found between men and women bank managers on initiative, cooperation, and quantity of work. Performance differences between sexes have been shown to be due to both individual managerial characteristics and the structure of the organization itself. For example, women supervisors are often found to become so engrossed in intraorganizational activities that they tend to lose their perspectives and fail to consider important factors external to the organization. Such is the case when a supervisor becomes completely absorbed with operational efficiency and ignores competitive actions outside the company. The supervisor who is aware of departmental operations and external events can effectively react to a competitor's action. Men supervisors, however, are highly concerned about external events to the organization and are found to utilize external information more effectively in accomplishing personal as well as organizational goals and objectives [1].

Research suggests that women managers exert greater effort than men to comply with organizational policies and procedures; however, men have been found to delegate authority more effectively to subordinates. Women supervisors, especially at lower organizational levels, are found to delegate authority poorly. In addition, women managers use more nonmonetary rewards to motivate subordinates than do men supervisors who use more monetary type (more effective) rewards [1].

In order for women to advance in organizations, they must become more effective delegaters of work. The importance of effective delegation lies in the additional time it allows for supervisory planning, organizing, and controlling of departmental operations—factors which are evaluated to indicate performance as a supervisor. Effective delegation of authority to subordinates is vital for individual growth and promotion in organizations. Delegation of authority can be considered the most important area for improvement in the managerial style of women managers.

Delegating Authority

Women supervisors must become more effective in delegating duties, obligations, and authority to subordinates. A supervisor who does not delegate properly will wind up overburdened with work and responsible for more work than one can accomplish personally. Not only is this supervisor robbed of sufficient time to effectively perform her job, but her subordinates are also deprived of opportunities to improve their performance and develop their abilities for taking on more responsibility and making decisions. When both a supervisor and her subordinates are stunted in managerial growth, then the organization will invariably suffer bottlenecks where work is not accomplished by overburdened managers, subordinates are undeveloped, and teamwork is incapable of responding to changing conditions and demand. As a result, such a supervisor's performance is not positively evaluated.

Are you suffering the symptoms of underdelegation? There are several questions you can ask yourself to answer this question:

1. Do you have to take work home at night?
2. Do you have little time for appointments, recreation, study, civic work, etc.?
3. Are you frequently interrupted because others come to you with questions or for advice or decisions?
4. Do you spend some of your working time doing things for others that they could do for themselves?
5. Do you have unfinished jobs accumulating or difficulty meeting deadlines?

**Assistant Professor of Management, East Carolina University, Greenville, North Carolina.*

6. Are you inclined to keep a finger on everything that is going on?
7. Are you too concerned about details that are not important for the main objectives of your position?

If you feel you are ineffectively practicing the art of delegation and desire improved communication with subordinates, it is helpful to understand why many supervisors do not delegate properly and why subordinates oftentimes do not accept delegated authority. Many supervisors feel the only way to finish work is to do it themselves, better known as the "I can do it better myself" fallacy. Many women managers especially feel a need to monitor closely a subordinate's work, or to be a perfectionist about details which do not affect the final outcome of a project. Although they get satisfaction from this personal involvement, women managers must force themselves to "give away" much work they like to do since it restricts attention which could be directed to planning, organizing, motivating, and controlling duties as well as focusing on problem areas. Coupled with a desire "to get the job done," a supervisor often lacks confidence in a subordinate's ability to make proper decisions, and hence is unwilling to take the risk associated with being accountable or responsible for a subordinate's decisions. In this case, a woman supervisor would do well to remind herself that "a manager is only as good as the team around him/her" and that effective delegation creates an effective team. Although responsiblity and accountability cannot be delegated, authority must be. When a woman supervisor is reluctant to delegate due to the risks of accountability for a subordinate's decision, she must communicate with her subordinate to develop a better understanding of his/her capabilities and capacity. In this situation, a supervisor must maintain closer monitoring and evaluation of a subordinate's performance on the job. A common failure in the supervisor-subordinate relationship is the misunderstanding of an employee's potential and abilities. As seen, this misunderstanding leads to intraoffice conflicts, poor delegation, and reduced morale. A clear understanding of a subordinate's abilities and potential should be obtained so that each can be challenged through delegation of authority.

Another reason why many women managers fail to delegate properly is not knowing which tasks to delegate to which subordinates. In this situation, the supervisor can remedy her confusion as to who should perform what tasks by classifying each task by a determined importance criteria. One suggestion is to divide tasks into three groups. The first group is made up of senior tasks which the supervisor must handle herself. The second group of tasks includes those intermediate in difficulty which could be handled by a competent subordinate. The third group are routine tasks which can be easily delegated. Tasks within each group (level) should then be matched to a particular subordinate's skills and ability. A division of tasks and duties into levels will not only clarify a subordinate's job but, in addition, will reduce the time involved in delegating tasks. This time saving will allow the supervisor to devote more time and energy to planning and problem solving. It is important to note here that when specific tasks are delegated, the supervisor should make clear to subordinates the importance of those tasks to the department and organization. This clear understanding is especially needed when "simple but time-consuming" tasks are delegated.

Often a woman supervisor does not delegate duties because she does not understand her authority level. This situation causes confusion among subordinates and reduces career development opportunities in the department or organization. A supervisor in this environment should immediately seek assistance from her superior(s) to clarify her authority levels. Once she clearly understands her responsibilities and boundaries of authority, she can define a subordinate's level of authority needed for making decisions. Again, a classification system will aid the supervisor in delegating authority levels to subordinates. This can be accomplished as follows: Level A can consist of complete power of authority in getting the job done. Level B would be the authority to act in job-related matters, but requires reporting to the supervisor. The lowest level in the authority classification system, Level C, would be the authority to act on a job-related matter after approval from the supervisor. This classification allows the supervisor a much easier format for delegating tasks, and also allows her more time and flexibility for other managerial responsibilities. She is not "trapped" as before into making decisions that her subordinates could and should make. Supervisors should always remember that effective delegation improves departmental operational efficiency and employee morale. Female supervisors especially must encourage, and sometimes force, subordinates to make decisions. Resistance by subordinates may take place as they fear their own accountability for a decision's outcome. However, the supervisor must not be intimidated by this resistance and must reassure subordinates that they are responsible and accountable only to her, so "do the best job you can." She must not make decisions which are within the realm of subordinates' authority or negative results will occur. That is, subordinates will be deprived of the opportunity to become more "important" employees and will consequently contribute less to the achievement of department goals.

Benefits of Effective Delegation

Numerous benefits are derived through effective delegation of authority. Specifically, women supervisors can be expected to improve their ratings on dependability, technical competence, communication skills, and quality of work through more extensive delegation. In addition, a primary benefit of effective delegation is that employee morale and productivity increase. Delegation allows employees to develop potential supervisory skills which, according to Abraham Maslow, allows progression towards fulfillment of one's self actualization needs. More importantly, the supervisor develops competent subordinates on whom she can rely and who have a personal commitment to her and the department. As subordinates become more effective decision-makers, the supervisor can conduct more reliable performance reviews based on realistic performance standards. This, coupled with better relations and communication between the supervisor and her subordinates, clarifies relationships between personal, departmental, and organizational goals. Therefore, effective delegation leads to increased efficiency and improved profitability.

As with all things, practice and awareness heightens one's ability in any activity. Once delegating tasks effectively, the woman supervisor needs to periodically examine her approach. Ask yourself the following questions to check your delegation effectiveness ("Yes" answers indicate positive responses).

Do you:

1. Try to create a climate which is relaxed, informal, and comfortable?
2. Encourage and provide time for group discussion and communications?
3. Make sure that objectives and goals are well defined, measurable, and understood by all team members?
4. Make allowances for the airing of disagreements and differing points of view?
5. Encourage "leveling" and frank and open criticism?
6. Provide an atmosphere where subordinates are free to express their feelings?
7. Make sure no one person assumes a dominating role?

In conclusion, the woman supervisor who effectively delegates authority and duties to subordinates will improve her job performance. More time for planning, organizing, motivating, and controlling will allow coordination of goal-oriented criteria. Meanwhile, the supervisor can become more aware of events external to her department and can aggressively utilize external information for herself as well as for her department. Effective delegation of authority allows a woman greater opportunity for advancement into higher levels of supervisory management.

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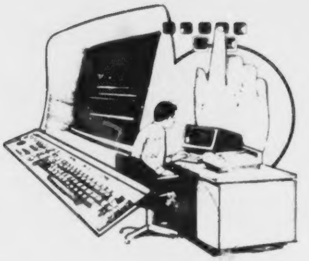

by Peter L. McMickle, Ph.D., C.P.A.

EVALUATING MICROCOMPUTER SYSTEMS PERFORMANCE: FOCUS ON THE NATURE AND STRENGTHS OF "16-BIT" MACHINES

When IBM introduced its new Personal Computer in the fall of 1981, it was hailed as the beginning of the "16-Bit Revolution." IBM's PC was soon followed by Radio Shack's Model 16, and now there are dozens of 16-bit computers from which to choose. These include the Hewlett-Packard Series 200, the Texas Instruments Professional Computer, the Corvus Concept, the Fortune 32-16, and the Victor 9000.

Many professionals have written about these machines and many more have discussed them publicly in various capacities. Not so many of these individuals actually understand what "16-bit" means. It is, in fact, an oversimplification to refer just to the bit size in discussing computer performance. Certain 8-bit machines can outperform other 16-bit varieties. Actually, there are three major performance characteristics of microprocessing computer chips:

(1) Bit size which is computer word size expressed in bits,
(2) Clock speed expressed in cycles per second or MHz, and
(3) Addressable memory expressed in bytes.

Computer Word or Bit Size

When digital computers were first developed in the late 1930s and 1940s, numbers were represented internally as off and on switches controlled by vacuum tubes (roughly analogous to the light switches in your home). The same principles are still used today. A single binary number which can be either 0 for off or 1 for on, as represented by an open or closed circuit, is referred to as a "bit"—the smallest and most basic unit of information in a computer. Most of the newer computer chips operate on five volts, so a binary zero bit is expressed when around zero volts are passed (0 to .4 volts) and a binary one bit when around five volts are passed (2.4 to 5.0 volts).

A computer is basically an adding machine that operates very fast. Multiplication, division, and subtraction are all accomplished with specialized forms of addition. Many of us have performed similar feats by hand with 10-key adding machines. The computer can also compare two numbers (logic), perform arithmetic and logic steps according to a series of instructions (a program), and use the results for many purposes, such as controlling an electron beam on a t.v. screen that is displaying your favorite computer game.

The number of bits which can be operated on at a single moment, lasting a few millionths of a second, depends upon the size of the registers holding the binary numbers which are to be "added" (operands). A "16-bit" machine has registers with 16 positions which can hold a combination of 16 zeros and ones. A true 16-bit machine should also have a 16-wire data bus that transports the bit information to and from internal memory. A computer that moves and operates on 16 bits at a time is said to have a computer word size of 16 bits.

In comparison to an 8-bit computer, a 16-bit system can perform arithmetic and logic steps on twice as much data in the same period of time. Does this mean that a 16-bit computer is twice as fast as an 8-bit? Not necessarily; computer speed is a function of many factors, including the basic response time of the various electronic components. Computer execution is regulated by its clock frequency or speed.

Clock Speed

Like most any electronic machine, a microprocessing chip operates at a pre-set speed: the faster the speed, the

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The author is Associate Professor of Accountancy, Memphis State University, Memphis, Tennessee.

faster the performance of the computer. If all other factors were equal, a 16-bit computer operating at a speed of 4,000,000 cycles per second or 4 MHz would execute a program in approximately the same time as an 8-bit chip operating at 8 MHz.

It is not easy to make a chip run faster. Speed is limited by the steady state coefficient or response time of its electronic components. In other words, there is a lag time for electronic devices in changing from one state to another state and achieving stabilization.

One of the most popular 8-bit chips is Zilog's Z-80. It is used in the Model I, II and III TRS-80 computers from Radio Shack. The original Z-80 operated at 2.5 MHz; current computers use a 4 MHz version. Late in 1982, Zilog introduced the Z-80H in competition with 16-bit microprocessors. The Z-80H is an 8-bit chip that operates at 8 MHz. Its performance is expected to exceed that of the standard 4 MHz version by a fraction of four to six. Later in 1983, Zilog will introduce the Z-800, an 8-bit machine with an internal clock speed of *25 MHz*. The Z-800 will also compete with 16-bit machines on another performance factor, addressable memory.

Addressable Memory

Data are stored in computer memory devices in the form of bits, but a single bit can code only two things. A series of bits taken together can be used to represent a greater number of things such as various characters. Such a string of bits is referred to as a byte. The industry standard is 8 bits to the byte, but there are a few obscure computers that use different sized bytes (notably six bits).

Eight bits can form 256 possible combinations. In other words, eight zeros and ones can form 256 different binary numbers from 00000000 to 11111111. These 256 possibilities can be used to represent the single digits 0 through 9, upper and lower case letters A through Z, special characters like punctuation marks with lots of room left over for the addition of new characters and check digits. One coding scheme, for example, called EBCDIC (Extended Binary Coded Decimal Interchange Code) represents the capital letter A as 1100 0001. Although computer manufacturers could refer to memory size in terms of bits, they have elected to use bytes because a "byte" closely equates to the general notion of a "character."

In today's computers, memory chips are structurally separate from the central processing unit (microprocessing CPU chip). They are connected to the CPU by several cable lines called buses. Earlier we mentioned the 16-line data bus in a 16-bit computer that transfers data in the form of binary numbers (on and off states) between the memory devices and the microprocessor. In a typical configuration there are also control buses and an address bus.

The address bus indicates exactly where the data are presently located or are to be stored. Most 8-bit chips have *16* address lines. Since each line can convey only two states, 16 lines can communicate two to the power of 16 (2^{16}) or 65,536 different addresses. Two to the power of 10 (2^{10}), which is 1024, is commonly abbreviated as K. So 65,536 (2^{16}) is equivalent to 64K, and most 8-bit chips are able to address 64K of memory because they have a 16-bit address bus.

A typical 16-bit chip will have four more address lines which provide for 2^{20} or 1,024,000 addresses (1M). But not all computer chips conform to these general specifications. The 8-bit Z-800, for instance, will be able to address 512K of memory. Thus, not all 8-bit chips have equivalent performance, nor do all 16-bit chips. Below are the performance specifications for some of the more popular 16-bit chips.

Texas Instruments 9900. A well kept secret is that the Texas Instruments 99/4A Home Computer, currently advertised by Bill Cosby at $149.00 (after rebate), is powered by a 16-bit chip—the TI9900. This is seldom mentioned because the 9900 is an early version 16-bit chip that can directly address only a maximum of 64K (some special tricks can extend this to 128K). The 9900 operates at a clock speed of 3.3 MHz.

Intel 8088. The popular IBM Personal Computer uses the Intel 8088 micro chip, as does the new Texas Instruments Professional Computer. Although the 8088 has 16-bit registers, the pen count for the data bus is only 8 lines. This was done so the machine could interface with already developed 8-bit computer peripherals such as printers and terminals. Thus, the IBM PC is not a true 16-bit computer. The 8088 can potentially address 2^{20} or 1M bytes of memory, and there are two versions of clock speed, 5 MHz and 8 MHz. The PC operates at 5 MHz.

Zilog Z8000 Series. Commodore has announced that its next generation of personal computers will use the Z8000 chips. The Z8000 was the second of the new generation of 16-bit microprocessors. It is offered in two modes: a complex Z8001 and a simple Z8002. The Z8001 uses a 16-bit data line, and its 16 registers can be paired into eight *32-bit* registers. It can directly address up to 8 megabytes of memory (up to 48M with segmentation), and it operates at a clock speed of 8 MHz.

Motorola Corporation 68000. The latest of the new generation of 16-bit chips is the MC 68000. Radio Shack's Model 16, Hewlett-Packard's Series 200, and Apple's Lisa all use the 68000. This is a much more powerful chip than the 8088 used in IBM's PC. The 68000 directly addresses 16M on a 24-line address bus, as opposed to the 8088's one megabyte of addressable memory. While the 8088 has seven 16-bit registers, the 68000 has seventeen *32-bit* registers. The 68000 has a 16-bit data bus connection where the 8088 data bus has only 8 bits. Like the 8088, the MC 68000 is available in an 8 MHz version, the 68000L.

Conclusions

The current microcomputer revolution began in 1971 when Intel introduced a "computer-on-a-chip," the 4-bit 4004. Several similar devices followed from various manufacturers, but it was not until April 1974 that a highly useful 8-bit chip was produced by Intel called the 8080. Improved versions were offered first by Motorola as the 6800 and then by Zilog which produced the Z-80. A major step forward was the development of a new generation of 16-bit chips: the I8088/8086, Z8000, and MC 68000.

Not everyone has followed these trends. In 1982, Digital Equipment Corporation introduced a *12*-bit microcomputer. This new computer uses software developed in the last decade for the PDP-8 minicomputer, which was also a 12-bit machine. Now, more advanced chips are entering the marketplace. Intel's iAPX432 is called a 32-bit micromainframe. Western Electric has a 32-bit chip called the Bell Mac 32 which may be used this year in a personal computer from the telephone company.

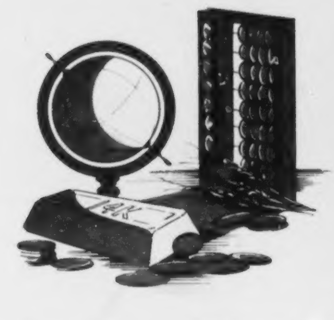
Referring to microprocessors as "8-bit," "16-bit," and "32-bit" is common but inaccurate oversimplification. Two "16-bit" microprocessors, the 8088 used in the IBM PC and the 68000 used in Radio Shack's Model 16, are contrasted below.

Differences in Two "16-Bit" Microprocessing Chips

	Intel 8088	Motorola Corp. 68000
Computer Word Size:		
Data Bus Pin Count	8 Bit	16 Bit
Register Size	16 Bit (7 total)	32 Bit (17 total)
Address Bus Pin Count	20 Bit	24 Bit
Clock Speed	5 MHz (IBM PC) 8 MHZ (Max.)	6 MHz (TRS Mod.16) 8 MHz (Max.)

The extent to which a particular brand of computer takes advantage of the potential of a microprocessor chip, both currently and with potential expandability, should be determined by direct reference to the manufacturer's specifications. Understanding the power and potential of these various machines requires more than a consideration of basic computer word size. Data bus configuration, register size, addressable memory, and clock speed should all be considered when making comparisons.

TAX CORNER



by Wm. Brent Carper, Ph.D, C.P.A.

TEFRA INVOKES NEW TAX PENALTIES

The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) has only been around since September 1982, but its impact already is being felt by both tax advisers and their clients. Few days seem to go by without some provision of TEFRA making the headlines of the daily newspapers and business chronicles. Unfortunately, we may have only scratched the surface.

The primary purpose of this Corner is to focus on two Internal Revenue Code sections amended by the new law. These sections are 6661 and 6701. Section 6661 adds a 10 percent penalty for "substantial" understatement of tax liability, and Section 6701 adds penalties for aiding and abetting the understatement of tax liability. Code Section 6700, dealing with abusive tax shelters, as well as the new fraud penalties also are briefly discussed.

"Substantial" Understatement of Tax Liability

Code Section 6661 adds a 10 percent penalty for "substantial" understatement of one's tax liability. As a matter of background, Congress intended to shift the burden of improving taxpayer compliance from the Internal Revenue Service to the taxpayer and preparer. Congress apparently felt that such a move was necessary to shore up the IRS, which has been hurt by budget cuts and increasing turnover. The IRS may invoke the 10 percent penalty on understatements of income tax for returns due after December 31, 1982, if the so-called understatements meet certain tests:

1. Such understatements do not have to involve negligence, but simply must meet the quantitative test of being substantial—that is the greater of either 10 percent of the required tax liability or $5,000.
2. The same basic rule applies to most corporations, except that the $5,000 understatement is replaced by one of $10,000.
3. The taxpayer must meet certain criteria before being subjected to the 10 percent/$5,000/$10,000 test. The primary criterion is the tax treatment of any item for which "there is or was substantial authority for such treatment."

Penalty Mechanics

For an individual taxpayer, substantial understatement means the greater of either 10 percent of the tax that should have been paid or $5,000. If the return showed a $17,000 tax liability, but the correct amount would have been $21,000, the understatement would not be substantial, e.g., the $4,000 difference is less than $5,000. If on another tax return, the declared tax was $80,000, but the correct amount would have been $88,000, the taxpayer still would not be subject to the new penalty, e.g., the $8,000 understatement is less than 10 percent of the $88,000 ($8,800) actual tax liability. However, if a taxpayer actually owed $36,000 according to the IRS, and paid only $24,000, such an individual would be subject to the penalty. The taxpayer's understatement of $12,000 fails both the $5,000 and the 10 percent tests.

Aiding and Abetting

The new Code Section 6701 imposes a $1,000 penalty for advisers (accountants, attorneys, and financial planners) who are found to have "aided and abetted" in the presentation of false documents or returns that result in known understatements of tax liability. In the event of a corporate taxpayer, the penalty is $10,000.

Although the penalty is a civil as opposed to criminal penalty, nevertheless, its scope is quite broad. Specifically, it appears that a "false" statement or return in this context will not require the same degree of willfulness as in the case of fraud. The IRS simply may assess the penalty based on the grounds that the adviser provided information that was contrary to current IRS regulations and rulings.

The partner of a CPA firm can be liable under the penalty for almost anything done by anyone under his/her supervision, if it can be demonstrated that the partner was aware of the subordinate's actions. In the case of limited partnership syndications for instance, a CPA could be

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The author is Associate Professor of Accountancy, Memphis State University, Memphis, Tennessee.

exposed to a penalty of $1,000 for each partner. Additionally, to the extent that any of the limited partners were corporations, the CPA's penalty would be $10,000 for each of them. Correspondingly, taxpayers can expect that return preparers, in all likelihood, will give increased scrutiny to client-submitted information due to the evertightening preparer regulation standards.

Abusive Tax Shelters

Amended Code Section 6700 provides a stiffer penalty for tax advisers and promoters who make fraudulent claims about tax shelters or help taxpayers fraudulently reduce their taxes accordingly. For the penalty to apply, the IRS simply must determine that the offender made a statement that he/she knew to be false or fraudulent about "any material matter" involving the tax effects or that provides a "gross" valuation overstatement of the shelter.

The new penalty is $1,000 or 10 percent of the gross income "derived or to be derived by such person from such activity." It should be emphasized that the penalty can be imposed on not only the organizers, but also the participants, in the sale of tax shelters as well.

Tougher Fraud Penalties

TEFRA has increased the fraud penalties. Specifically, the law applies a 50 percent penalty to the interest payable on fraudulent tax understatements. The current civil fraud penalty already is an additional 50 percent on the "underpayment" if all or any part of it can be proven to be the result of fraud.

The new law also increases criminal fraud fines. A practitioner now can be fined $100,000, if convicted of willfully attempting to evade or defeat any tax. A corporation, functioning as an adviser, can be fined $500,000. Additionally, TEFRA increases the fine for delivering false or fraudulent documents to the IRS. The fine is now $10,000 for most taxpayers and $50,000 for corporations. Under prior law, the amount was $1,000.

Conclusions

Only time will tell how the courts will view the new penalty provisions. In the meantime, tax advisers will continue to remain uncertain as to the extent of their personal exposure as relates to the new penalties. Taxpayers can expect their normally conservative accountants and attorneys to be even more conservative, and their assertive financial planners suddenly to become less aggressive. In short, the taxpayer may have to buy tax shelters without the aid of a qualified adviser, or be satisfied with less aggressive types of shelters.

The new penalties imposed by TEFRA are both complex and in some cases vague. Thus, the reader is encouraged to seek the help of his/her tax adviser for a detailed explanation of the topic.

U. S. CONSUMER PRICE INDEX - U[1] (UNADJUSTED)
1967 = 100.0

				Percent Change			Percent Change			Percent Change			Percent Change			Percent Change	
Month	1978 CPI	1979 CPI	1980 CPI	Month Ago	Year Ago	1981 CPI	Month Ago	Year Ago	1982 CPI	Month Ago	Year Ago	1983 CPI	Month Ago	Year Ago	1984 CPI	Month Ago	Year Ago
Jan.	187.2	204.7	233.2	+ 1.4	+13.9	260.5	+ 0.8	+11.7	282.5	+ 0.4	+ 8.4	293.1	+ 0.2	+ 3.8			
Feb.	188.4	207.1	236.4	+ 1.4	+14.1	263.2	+ 1.0	+11.3	283.4	+ 0.3	+ 7.7	293.2	+ 0.0	+ 3.5			
March	189.8	209.1	239.8	+ 1.4	+14.7	265.1	+ 0.7	+10.6	283.1	- 0.1	+ 6.8	293.4	+ 0.1	+ 3.6			
April	191.5	211.5	242.5	+ 1.1	+14.7	266.8	+ 0.6	+10.0	284.3	+ 0.4	+ 6.6						
May	193.3	214.1	244.9	+ 1.0	+14.4	269.0	+ 0.8	+ 9.8	287.1	+ 1.0	+ 6.7						
June	195.3	216.6	247.6	+ 1.1	+14.3	271.3	+ 0.9	+ 9.6	290.6	+ 1.2	+ 7.1						
July	196.7	218.9	247.8	+ 0.1	+13.2	274.4	+ 1.1	+10.7	292.2	+ 0.6	+ 6.5						
Aug.	197.8	221.1	249.4	+ 0.6	+12.8	276.5	+ 0.8	+10.9	292.8	+ 0.2	+ 5.9						
Sept.	199.3	223.4	251.7	+ 0.9	+12.7	279.3	+ 1.0	+11.0	293.3	+ 0.2	+ 5.0						
Oct.	200.9	225.4	253.9	+ 0.9	+12.6	279.9	+ 0.2	+10.2	294.1	+ 0.3	+ 5.1						
Nov.	202.0	227.5	256.2[a]	+ 0.9[a]	+12.6[a]	280.7	+ 0.3	+ 9.6	293.6	- 0.2	+ 4.6						
Dec.	202.9	229.9	258.4	+ 0.9	+12.4	281.5	+ 0.3	+ 8.9	292.4	- 0.4	+ 3.9						
Annual Avg.	195.4	217.4[a]	246.8			272.4			289.1								
Annual Change	--	11.4	13.5			10.4			6.1								

[a] Revised.

[1] The Consumer Price Index for All Urban Consumers reflects the buying habits of about 80 percent of the non-institutional civilian population of the U.S. and also uses a market basket based on the 1972 and 1973 expenditure survey.

Source: U.S. Department of Labor, Bureau of Labor Statistics.

Prepared by: Bureau of Business and Economic Research, Memphis State University.

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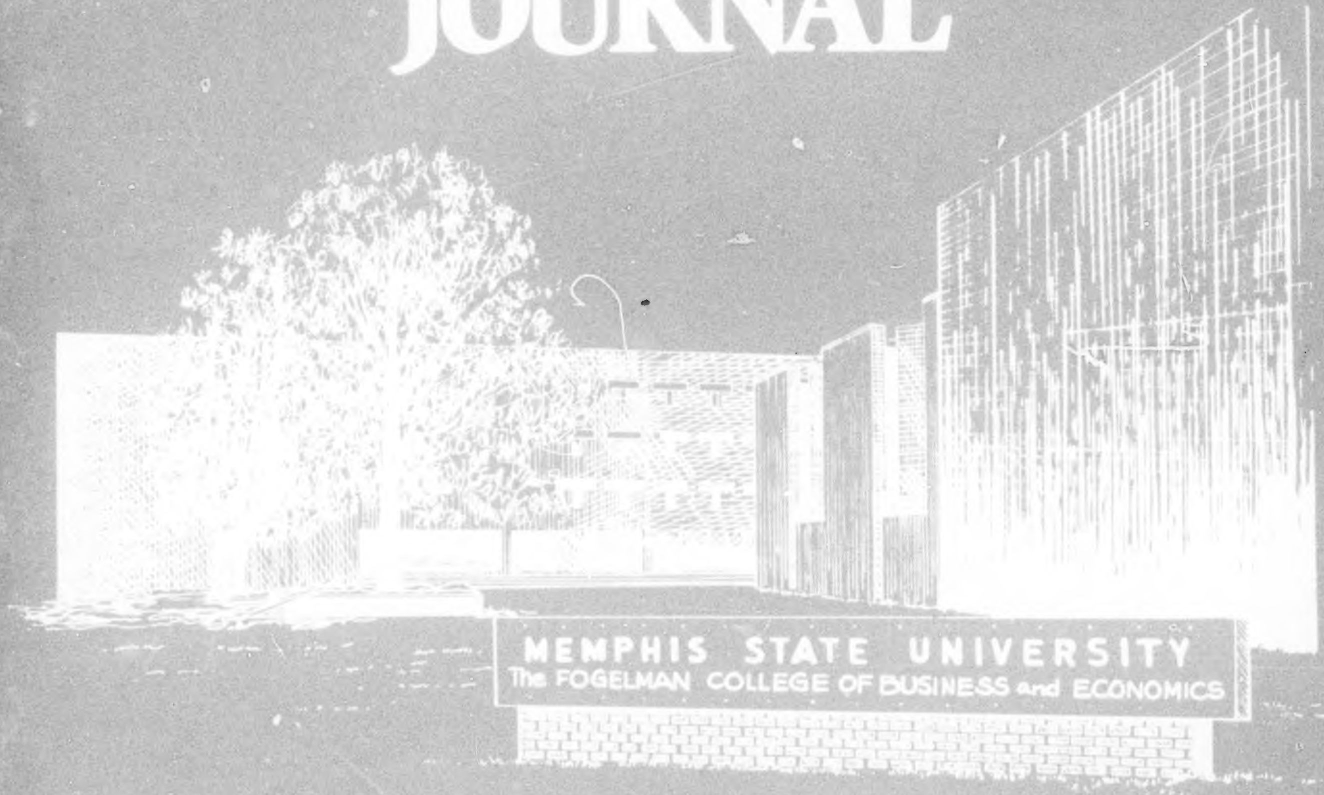
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DETERMINANTS OF ADJUSTMENT IN PRICE AND NON-PRICE MARKETING INTENSITIES

*David D. Shipley**

This is the third in a series of articles which, through an analysis of data provided by 728 British manufacturing firms, is attempting to contribute to a better understanding of pricing and non-price marketing behaviour.[1] The preceding paper [28] examined several dimensions of pricing flexibility. It concluded that when the survey was undertaken in 1979, pricing flexibility was substantial and that it was more extensive than Skinner found in a similar survey some ten years previously [30]. It also concluded that this was because firms had learned to react to changes in the conditions of what Porter has called firms' "extended rivalry" [23], [24] which were pressing in a particularly hostile manner during the years up to and including the survey. Specifically, the widespread flexibility was attributed to strong and sustained upward pressure on input prices caused by suppliers passing on cost inflation and to powerful and prolonged downward pressure on output prices emanating from slumberous demand among customers, accelerating new entry from overseas, new product substitution, and competition among existing sellers. The purpose of the current paper is to present data which corroborate these arguments. It reports a broad prevalence of price and/or non-price marketing reaction both when adversity intensifies and when it relents.[2] However, there is also a suggestion of considerable non-responsiveness in the face of some potentially very eventful contingencies.

The findings are compared among the firms classified by numbers employed and by numbers of "serious" competitors in the British market. Information about the groupings is presented in Table I. Throughout the paper and the series the variation by firm size is more substantial, more systematic, and more consistent than by numbers of rivals.

Table I
GROUPINGS OF FIRMS IN THE SAMPLE

	Groupings by Number of Employees					Groupings by Number of Competitors				
Designation	E1	E2	E3	E4	E5[a]	C1	C2	C3	C4	C5
Class	<51	51-200	201-1000	1001-3000	>3000	0	1-4	5-9	10-25	>25
Frequency	178	244	217	55	34	26	271	205	129	97

[a] 25 of the firms employ more than 5000 workers.

The Findings

While it is important to research the causes of price adjustment, this should not be done independently of other considerations. Price is only one, albeit an important one, of the interrelated variables in a firm's marketing/competitive mix [4], [7], [8], [17]. Indeed, many of the businessmen interviewed by Kaplan et al. found it difficult to analyse the pricing decision as activity divorced from other policy areas [15]. Similarly, Hague's respondents encountered difficulty in distinguishing the effects on sales volume caused by price adjustments from those stemming from changes in non-price variables [11]. From the customers' perspective, a recent survey by the writer found that the source selection decision among distributors of manufactured consumer goods and industrial purchasers of capital goods is determined, respectively, as much and more by non-price factors as by price [27]. It is interesting, therefore, to explore the extent to which firms make allowance for the effects of their non-price activities when forming prices, since these have important implications concerning the impact of pricing decisions. The current respondents were asked, "When setting prices does your firm take full account of the likely effects of and on non-price factors in the marketing mix, such as product quality, advertising and sales promotions, after-sales services and performance on delivery?" Presented in Table II, the response indicates that very considerable attention is addressed to these interrelationships. More than one-half of the respondents always take account of them, and another three-tenths do so frequently; fewer than one-tenth infrequently contemplate the interrelationships, and only a handful ignore them completely. Generally, regard for the interconnections increases mildly with size of work force. By number of rivals, it is most prevalent among the firms with one to nine competitors where non-price competition is likely to be extensive, and it is least extensive among the monopolists where competition is absent. Overall, a sizable number of the

Table II
CONSIDERATION OF NON-PRICE MARKETING EFFECTS IN THE PRICING PROCESS

	All Respondents	Groupings by Number of Employees (%)					Groupings by Number of Competitors (%)				
	(%)	E1	E2	E3	E4	E5	C1	C2	C3	C4	C5
Never	4.1	6.7	4.1	3.2	1.8	0.0	19.2	2.2	4.4	3.9	5.2
Infrequently	9.2	14.0	7.4	7.8	7.3	8.8	11.5	9.2	8.8	10.1	8.2
Frequently	30.2	27.0	37.7	26.3	27.3	23.5	19.2	29.5	27.8	34.9	34.0
Always	56.5	52.2	50.8	62.7	63.6	67.6	50.0	59.0	59.0	51.2	52.6

**Senior Lecturer, Department of Management Studies, North Staffordshire Polytechnic, Stoke-on-Trent, England.*

firms do not always adopt a comprehensive view of the entire marketing effort, and this is likely to retard the efficacy of their pricing decisions. Nevertheless, it seems that price is more usually set with a view to its impact within the overall scheme of the marketing programme, and this is more conducive to the achievement of satisfactory outcomes within the constraints laid down by the forces of extended rivalry.

In four separate questions the respondents were asked to consider the list of contingencies shown in Table III and to indicate which of them usually cause their firms to (a) decrease prices, (b) increase prices, (c) strengthen non-price marketing intensities, and (d) relax non-price marketing intensities.[3] The 17 contingencies presented can be classified into five groups, four of which account for changes in the conditions of firms' extended rivalry. These comprise changes in costs, demand, the firms' own prices and non-price intensities, rivals' prices and non-price competitiveness, and new entry and exit. The fifth group is an amalgam of changes in firms' aspirations for profits, revenues, and market shares. The respondents were not asked about the fifth element of Porter's extended rivalry, new product substitution.[4] However, it is possible that at least some of the respondents might regard this as the equivalent to new entry with existing products.

Collectively, the contingencies call forth much price and non-price adjustment among the sample. Moreover, as Table IV illustrates, some of the firms implement joint price and non-price reactions to 13 of the contingencies. When these latter are taken into account, it is possible to identify the numbers of firms which effectuate one or more adjustments in response to the particular causes listed in Table III. More than one-half of the firms react to cost increases and decreases, contractions and expansions in demand, cuts and rises in competitors' prices, and their own requirements for bigger profits, revenues, and market shares. Between one-third and one-half of the respondents react to new entry attempts, improvements in rivals' non-price competitiveness, and increases in their own prices. However, fewer than one-third of the firms respond to improvements in their own non-price competitiveness and to deteriorations in that of rivals. Finally, fewer than one-quarter of the sample react to market exit by competitors, relaxation in rivals' non-price intensities, reductions in their own output prices, and "other" specified contingencies.

Table IV

JOINT PRICE AND NON-PRICE REACTION TO CONTINGENCIES

	Joint Reactions[a]			
Contingency	D and S (%)	I and S (%)	D and R (%)	I and R (%)
An increase in costs	—	28.7	—	8.8
A reduction in costs	1.6	—	5.5	—
An increase in demand	2.3	4.9	3.2	8.8
A decrease in demand	16.8	2.6	2.3	1.1
A rise in competitors' prices	—	4.7	—	7.6
A reduction in competitors' prices	19.2	—	2.3	—
Improvement in rivals' non-price competitiveness	8.1	0.8	—	—
Decline in rivals' non-price competitiveness	—	0.8	—	3.2
New competitors' attempts to enter the market	17.7	—	—	—
One or more competitors pull out of the market	—	0.4	—	2.5
Your firm wishes to increase market share	28.4	—	—	—
Your firm wishes to increase revenue	13.5	12.8	—	—
Your firm wishes to increase profits or return on capital	4.3	21.4	—	—

[a] D and I represent, respectively, decrease and increase price; S and R denote, respectively, strengthen and relax non-price marketing.

Major causes of price cutting are reductions in costs and rivals' prices, bigger market share targets, decreases in demand, and other firms' attempts at new entry. Only about one-twelfth of the respondents claimed that none of the contingencies induces price cuts, seven-tenths specified multiple causes, and the mean number was 2.7. Leading inducements to price rises are increases in profit requirements, demand, rivals' prices, and, most notably, costs. All of the respondents cited at least one of the contingencies as causes of higher prices, eight-tenths referred to multiple influences, and the mean was 3.0. Prominent determinants of attempts to improve non-price marketing are larger profit, revenue and market share requirements, decreases in demand, improvements in the price and non-price competitiveness of rivals, new entry attempts, and increases in the firms' own prices. Only about one-twelfth of the firms do not attempt to strengthen their non-price efforts with any of the contingencies, four-fifths respond to more than one of them, the mean was 4.0, and without being asked, a handful of the respondents claimed that their firms' attempts to bolster non-price competitiveness are perpetual. Moreover, the most prominent contingency cited as resulting in (deliberate?) deintensification of non-price marketing effort is an increase in demand, and this is restricted to three-tenths of the firms. Close to one-half of the sample do not relax non-price intensities in response to any of the contingencies, few more than one-quarter declared multiple causes, and the mean number was only 1.0.

The findings indicate a strong ratchet effect on the intensification of non-price marketing generally, as well as perhaps on individual variables like that discussed by Pickering in relation to advertising [22]. The more general intensification might be a result of customer demand for product or service improvement or it may be due to entry forestalling or rivalry in industries where firms feel compelled to follow the non-price improvements of competitors, with none daring to initiate cut-backs. Further, writers like Borden [3], Cowling [5], and Dean [6] have posited logical arguments for treating the effects of advertising as a capital asset, so that over time reductions in advertising appropriations will have a cumulative adverse effect perhaps resulting in greater revenue losses than cost savings. While advertising might be an effective

Table III
DETERMINANTS OF ADJUSTMENT IN PRICE AND NON-PRICE MARKETING VARIABLES

Contingency	Reaction[a]	Rank by Reaction	All Respondents (%)	Groupings by Number of Employees (%)					Groupings by Number of Competitors (%)				
				E1	E2	E3	E4	E5	C1	C2	C3	C4	C5
An increase in demand	D	8	11.3	7.9	13.9	12.4	7.3	8.8	3.8	11.8	10.2	14.0	10.3
	I	5	22.1	16.3	21.3	24.9	32.7	23.5	26.9	15.9	23.4	24.0	33.0
	S	10	18.4	18.0	17.6	18.0	23.6	20.6	11.5	19.2	19.5	17.8	16.5
	R	1	29.9	27.5	32.8	30.0	29.1	23.5	23.1	29.2	28.8	33.3	32.0
A decrease in demand	D	4	30.1	19.7	31.6	34.1	40.0	32.4	26.9	24.4	30.2	36.4	38.1
	I	9	5.8	2.2	5.3	7.8	7.3	11.8	0.0	5.5	5.9	7.0	6.2
	S	2	42.9	35.4	43.9	47.0	41.8	50.0	38.5	38.7	45.4	41.9	51.5
	R	5	7.7	7.3	6.1	7.4	12.7	14.7	3.8	8.1	9.3	6.2	6.2
An increase in costs	D	15	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	I	1	97.3	96.1	97.5	98.2	94.5	100.0	96.2	97.8	96.6	96.1	92.8
	S	9	29.8	23.0	30.7	32.3	40.0	26.5	7.7	28.0	30.2	33.3	35.1
	R	4	9.2	5.6	8.2	11.5	16.4	8.8	7.7	8.1	10.2	10.1	9.3
A reduction in costs	D	1	48.4	56.7	49.6	45.2	38.2	32.4	34.6	45.8	51.2	48.1	53.6
	I	13	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	S	13	5.9	5.6	7.4	4.6	5.5	5.9	0.0	4.8	6.8	6.2	8.2
	R	7	6.2	6.7	5.3	6.0	10.9	2.9	3.8	8.1	4.4	7.0	4.1
A rise in your firm's prices	D	—	—	—	—	—	—	—	—	—	—	—	—
	I	—	—	—	—	—	—	—	—	—	—	—	—
	S	5	36.1	26.4	37.3	41.0	43.6	35.3	19.2	33.9	38.5	42.6	33.0
	R	11	1.9	1.7	2.9	1.8	0.0	0.0	3.8	1.1	3.4	0.8	2.1
A reduction in your firm's prices	D	—	—	—	—	—	—	—	—	—	—	—	—
	I	—	—	—	—	—	—	—	—	—	—	—	—
	S	16	2.6	3.4	2.9	2.3	0.0	2.9	0.0	0.7	2.9	3.1	7.2
	R	9	5.5	3.9	5.3	5.5	12.7	2.9	3.8	5.9	5.4	7.8	2.1
A rise in competitors' prices	D	15	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	I	3	46.6	32.0	46.3	50.2	67.3	67.6	38.5	50.9	43.9	48.8	39.2
	S	11	7.3	6.2	7.8	5.5	10.9	14.7	0.0	7.7	8.3	7.8	5.2
	R	3	11.1	10.1	13.1	10.1	14.5	2.9	3.8	11.1	8.3	17.8	10.3
A reduction in competitors' prices	D	2	46.7	30.3	45.9	51.2	74.5	64.7	30.8	45.4	44.9	55.8	46.4
	I	13	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	S	8	31.6	24.7	32.0	35.9	36.4	29.4	23.1	31.7	37.1	32.6	20.6
	R	10	3.3	3.4	3.7	2.3	3.6	5.9	0	2.2	4.9	3.9	3.1
An improvement in your firm's non-price competitiveness	D	12	5.4	2.8	6.6	5.1	7.3	8.8	3.8	6.6	4.9	3.9	5.2
	I	4	25.1	16.3	22.5	27.2	49.0	38.2	26.9	26.9	24.9	24.0	21.6
	S	—	—	—	—	—	—	—	—	—	—	—	—
	R	—	—	—	—	—	—	—	—	—	—	—	—
A decline in your firm's non-price competitiveness	D	7	15.2	8.4	14.8	17.5	25.5	23.5	19.2	16.6	15.1	15.5	10.3
	I	11	3.2	5.1	4.1	1.4	1.8	0.0	0.0	4.1	2.9	1.6	4.1
	S	—	—	—	—	—	—	—	—	—	—	—	—
	R	—	—	—	—	—	—	—	—	—	—	—	—
An improvement in rivals' non-price competitiveness	D	9	9.5	2.8	9.0	13.4	16.4	11.8	11.5	8.5	10.2	12.4	6.2
	I	12	2.6	2.8	3.3	2.3	0.0	2.9	0.0	2.2	2.0	3.1	5.2
	S	3	42.6	29.8	39.3	48.8	61.8	61.8	34.6	42.1	47.8	42.6	35.1
	R	13	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
A decline in rivals' non-price competitiveness	D	13	1.1	1.7	1.2	0.9	0.0	0.0	0.0	1.5	1.0	0.0	2.1
	I	7	11.1	6.7	10.7	11.1	20.0	23.5	15.4	10.0	12.7	11.6	9.3
	S	14	4.0	2.8	5.7	3.2	1.8	5.9	0.0	4.1	5.4	2.3	4.1
	R	2	13.2	9.6	13.9	13.8	18.2	14.7	11.5	11.8	12.7	18.6	11.3
New competitors' attempts to break into the market	D	5	26.4	16.9	22.5	35.9	41.8	17.6	11.5	27.3	27.3	27.9	23.7
	I	13	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	S	6	34.9	16.9	33.2	42.4	43.6	50.0	23.1	36.2	35.6	41.9	23.7
	R	12	1.6	1.1	1.6	1.4	5.5	0.0	0.0	0.7	3.4	1.6	1.0
One or more competitors pull out of the market	D	14	0.8	0.6	1.2	0.9	0.0	0.0	0.0	0.4	0.5	2.3	1.0
	I	8	9.8	4.5	8.2	12.9	20.0	11.8	11.5	8.5	9.8	10.1	12.4
	S	14	4.0	3.4	4.1	3.7	5.5	5.9	3.8	3.0	5.4	3.1	5.2
	R	6	6.9	6.2	6.6	7.8	5.5	8.8	3.8	7.4	5.4	7.0	9.3
Your firm wishes to increase its market share of sales	D	3	38.5	28.7	39.8	41.5	49.1	44.1	26.9	41.0	35.6	39.5	39.2
	I	—	—	—	—	—	—	—	—	—	—	—	—
	S	1	59.9	53.4	55.7	65.9	74.5	61.8	50.0	63.8	59.0	65.1	46.4
	R	—	—	—	—	—	—	—	—	—	—	—	—
Your firm wishes to increase its profits or return on capital	D	10	6.9	2.8	9.4	8.8	1.8	5.9	7.7	5.2	7.8	9.3	6.2
	I	2	48.4	34.3	42.2	56.2	78.2	67.6	38.5	49.1	49.3	51.9	42.3
	S	7	32.8	24.7	31.6	38.7	38.2	38.2	50.0	32.5	32.7	37.2	23.7
	R	—	—	—	—	—	—	—	—	—	—	—	—
Your firm wishes to increase its sales revenue	D	6	21.6	9.6	24.6	27.2	25.5	20.6	11.5	21.0	22.0	23.3	22.7
	I	6	21.0	19.1	20.9	21.2	25.5	23.5	23.1	20.7	22.4	18.6	21.6
	S	4	40.9	38.2	39.3	42.4	50.9	41.2	38.5	40.6	39.0	45.7	40.2
	R	—	—	—	—	—	—	—	—	—	—	—	—
Others specified[b]	D	11	5.9	5.1	2.9	7.8	9.1	14.7	7.7	5.9	5.4	5.4	7.2
	I	10	3.3	3.9	1.6	4.1	5.5	2.9	11.5	3.7	2.9	1.6	3.1
	S	12	6.7	7.3	6.1	6.0	7.3	17.6	0.0	7.7	6.8	7.0	5.2
	R	8	5.9	7.3	5.7	4.6	7.3	5.9	11.5	5.9	5.8	4.7	6.2
None	D		8.4	10.7	7.8	8.8	3.6	5.9	23.1	7.4	10.2	4.7	8.2
	I		0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	S		8.4	13.5	9.4	5.5	3.6	0.0	15.4	6.6	11.2	7.8	14.4
	R		45.3	47.2	45.1	45.6	38.2	47.1	42.3	45.0	44.9	48.8	43.3
Respondents who cited multiple reasons for the reaction	D		71.4	55.1	73.4	78.8	83.6	76.5	57.7	70.8	67.8	76.0	78.4
	I		79.3	68.0	77.5	83.4	100.0	91.2	73.1	81.9	75.6	78.3	82.5
	S		80.5	71.3	79.5	86.2	92.7	88.2	69.2	83.4	81.0	79.8	75.3
	R		27.5	24.7	27.0	25.8	45.5	26.5	23.1	29.5	24.9	32.6	21.6

[a] D and I represent, respectively, decrease and increase price; S and R denote, respectively, strengthen and relax non-price marketing.

[b] 43 respondents cited "other" reasons for price reductions, e.g., to acquire large orders (5 firms), exchange rate variations (4), to maintain high capacity working (3), new product launches (3), to off-load excess stocks (3); 24 respondents offered "other" reasons for price increases, e.g., exchange rate variations (7), to finance bigger expenditures on non-price factors (3), to choke-off demand when products are to be discontinued (3); 49 respondents gave "other" reasons for non-price improvements, e.g., to achieve ongoing improvements (20), customers' requests (9), to develop new markets (4); 43 respondents provided other reasons for non-price relaxation, e.g., full order books (9), complacency (4), to phase-out demand when products are to be discontinued (3).

and/or convenient vehicle for the presentation of information about standards of quality, delivery, after-sales services, and so on, there is no reason why the capital nature of the effects of advertising should not be extended to the impact of non-price marketing in general.

From a broader perspective, many of the contingencies stimulate different responses among groups of the respondents as, for example, in the case of an increase in demand. This probably reflects differences in the strength of the particular forces of extended rivalry faced by the firms, or disparate methods of problem solving fashioned by different perceptions, learning, aspirations, or decision-makers' power and strength of nerve when dealing with the elements of extended rivalry. While overall price and non-price reactions are seemingly extensive, some of the contingencies attract only moderate responses, others call forth adjustment from few of the respondents, and none of the firms react to all or most of the events. Moreover, the numbers of firms involved are smaller than the frequencies in Table III suggest since, as mentioned, some of the firms implement joint price and non-price reactions as shown in Table IV. It might be, though, that some of the firms do not regard some of the contingencies as being very important within the entire scheme of their operations, or that they have strong preferences for price and/or non-price stability.[5] Alternatively, some of the firms might never encounter some of the contingencies, or do so seldomly that they are not regarded as "usual" causes of adjustment. This draws some support from the blanket response to an increase in costs, which is the one contingency about which it can be confidently and unambiguously concluded that all of the firms have experienced during recent years. Moreover, not all possible causes of adjustment were put to the respondents, and exchange rate fluctuations, new product substitution, firms' own diversification programmes, and so on might be major reasons for price and non-price variation. Equally, the lists presented to the respondents were fairly lengthy, and they may have selected only the more important contingencies. Nevertheless, with one exception, sizable proportions of the respondents did not cite any reaction to each of the specific contingencies, and this might well be indicative of a substantial prevalence of price and non-price marketing myopia. If it is, and assuming that the sample is representative, one cause of decline in British manufacturing industry is indicated. However, some of the firms are clearly exempt from this charge. There is little that is myopic, for example, about the three-tenths of the sample which, as shown in Table IV, raise prices in the face of cost increases and also extend non-price involvement to forestall diminution in sales volume, market share, revenue, or profits.[6] Likewise, those firms strengthen both price and non-price competitiveness in reaction to new entry attempts and decreases in demand or to secure bigger market shares. While these actions might provoke retaliation from competitors, the firms implementing them can be expected to gain at least short-term benefits from being the initiators, and they may believe it is possible to call a truce if their advantage is later overturned.

As throughout this series, the variation of the frequencies reported here is more extensive, more systematic, and more consistent by numbers employed than by numbers of serious rivals.[7] Indeed, by the latter classification, the total price increase response to all of the contingencies varies barely at all and, excluding the group of monopolists, that of the three other kinds of reaction varies only moderately and somewhat irregularly. Overall, however, there is some small but generally confusing yet consistent variation by the extent of sellers' interdependence as (insufficiently)[8] indicated by numbers of rivals. The total frequency for each of the four types of reaction declines (to varying degrees) from the firms with ten to twenty-five rivals to those with five to nine, to those with between one and four to the firms with the most competitors to the monopolists which have none in the British market for their leading products. There does not seem to be a satisfactory full explanation for this sequence of variation. We might predict the monopolists to be the most inflexible marketers in terms of the sum of the contingencies, since some of them refer directly to the actions of rivals and others are likely to be influenced by the number and nature of competitors. However, even when the contingencies concerning rivals' actions are omitted, the monopolists remain overall substantially the least flexible group of firms except in the case of price increases, where there is little difference among the groupings by multiplicity of competitors.[9] On the other hand, we might expect the monopolists to be the most flexible marketers, since they would seem to have more scope for making adjustments when these are necessitated by changes in the pressures exerted by forces in their extended rivalry. For example, they need have no fear of reaction from existing rivals, and their market power may be exploited to extract the maximum surplus from suppliers and customers when relevant conditions alter.[10] However, Table III shows that the monopolists do demonstrate the least general reaction to the contingencies featuring market share aspirations and the activities of rivals, but they also react the least to new entry attempts and to changes in costs and demand. Perhaps the most satisfactory explanation for their relative rigidity is that the market dominance of the monopolists enables them to satisfy while leading a quiet life comparatively uncomplicated by the actions of other economic agents.

The overall flexibility of the firms with the most rivals is also less directly affected by the actions of rivals, and they are thus less likely to react to them. Moreover, the results of interactions among the elements in their extended rivalry reduce the latitude for adjustments in either price or non-price intensities. Customers can play off many sellers to force down prices, and this is likely to be compounded by open competition and the extent to which the firms strive to complicate relatively easy entry.[11] Hence, prices are likely to be set at or close to competitive levels, and this will force firms to constrain non-price marketing expenditures to cost-efficient proportions. In these circumstances, some price and non-price rigidity is to be expected. Notably, excluding the monopolists, the firms with the most rivals react the least to changes in rivals' competitiveness and to new entry, but they react the most to increases and decreases in demand.

As noted, price and non-price reactions are overall the most prolific among the three groups of possible oligopolists. While the latter is to be expected in oligopoly markets, the former runs counter to mainstream views concerning relative price rigidity in oligopoly. It is possible that incomplete information has resulted in the inclusion of non-oligopolists in these groups and that this has caused some distortion in the distribution of the frequencies.[12] Nevertheless, in the light of the information which is available, the inference is that oligopolists are no more, and even perhaps less, prone to price rigidity than firms in other market structures, and this was also suggested by some of the findings in [27] and [28]. An explanation is that manufacturers have been obliged to increase the extent of pricing flexibility by the particularly adverse change in the pressures stemming from elements in their extended rivalry. For example, there may be some international contagion of price lowering encouraged by dumping and the successful penetration of otherwise low-priced imports. Manufacturers' output prices may be depressed in some cases by the exploitation of countervailing market power by oligopsonistic customers, especially likely when demand is depressed. An alternative explanation, developed from the work of Sir David Orr, the Chairman of Unilever [32], and the writer's own findings [27], is that in a world of secular increase in real incomes, demand for other elements in the marketing mix, such as product quality, service, and delivery may have pared down the importance of price as a determinant in customers' source selection decisions so that manufacturers themselves are now less hesitant about adjusting prices. While these developments are equally likely to affect other firms, oligopolists, well practised in non-price adjustment, may have found it relatively easy to spread their marketing flexibility to the price front.

It is among the three groups of possible oligopolists where the consistent variation by the extent of firms' interdependence becomes difficult to explain. Of these, it is the firms with the most rivals which, for all four kinds of adjustment, demonstrate the most flexibility, and it is those with the fewest rivals which exhibit the most rigidity. This might be explained on the grounds that the former firms behave more like monopolistic competitors so that they have extensive involvement in product differentiating activities, whereas the possible "tight-knit" oligopolists are potentially the best able to establish and enforce collusive arrangements which are endangered by frequent price and non-price adjustment. Against this though, there are strong incentives to differentiate in tight oligopoly and as reported in [28]; some doubt is cast on the effective enforcement of collusion by the comparatively high frequency with which the possible "tight-knit" oligopolists engage in (implicitly secret) bargaining over price discount percentages with individual customers. Generally then, the variation among the three groups of possible oligopolists is enigmatic (to the writer at least) despite its being consistent.

Nevertheless, the variation is generally quite small, and with regard to particular reactions to specific contingencies it is usually small and often irregular. Further, there are a number of contingencies such as demand and cost changes to which the possible oligopolists are not the most responsive although there are others, like bigger market share requirements, new entry, changes in rivals' prices, and improvements in rivals' non-price marketing where predictably they are. Also, as the oligopoly literature would predict, the difference between these firms' adjustments and those of firms in the other two groups by numbers of rivals is generally more pronounced for non-price changes than for price adjustments.

By numbers of employees, the total frequency of each kind of adjustment increases steadily from the smallest firms to the second largest and then declines (in some cases sharply) among the biggest employers. Further, in close to three-fifths of the individual cases where contingencies induce positive reactions, the frequencies vary (and often markedly) from the smallest firms to the largest or, more usually, to the second largest. With regard to only one contingency, a reduction in costs, does the reaction vary inversely with firm size, and the more extensive and seemingly more propitious flexibility of the (second) largest firms is present in varying degrees of prominence in all of the five groups of contingencies. It is of conspicuous note though that reactions to changes in rivals' price and non-price competitiveness and to new entry are generally more extensive among the groups of largest firms than among any of the groups by numbers of competitors. The inference is that large firms feel more threatened by, or have more to protect from, the effects of rivals' actions than firms with few competitors and/or it confirms expectations that the former firms are the better equipped to do something about them. Explanations for the variations in flexibility among the firms by numbers employed were proposed in [28]. There, it was noted that small-firm controllers are often not well trained in pricing or marketing generally [31], whereas the potential for hiring specialists increases with size and, along with it, the resources necessary for appraising environmental conditions. Moreover, it was posited that "bigness" confers market power and other advantages which buffer firms from the effects of extended rivalry, thereby allowing them to devote more time and resources to the formulation of more efficacious price and (in the current context) non-price marketing decisions. Several alternatives were put forward to explain why the pricing flexibility of the largest firms was less than that of the second largest, and it was conjectured that the former had outgrown an optimal size range for pricing in particular and/ or marketing in general. The frequencies presented here show that overall the non-price adjustments of the largest firms are less extensive than those of the second smallest employers, although their price adjustments exceed those of the third largest. This gives more substance to the view that the largest firms have expanded past an optimal range for marketing in general.

Some of the results presented in this paper might be considered relevant in the context of the administered price hypothesis. However, from this perspective the findings are very confusing. The incidence of price cutting in response to a decrease in demand rises generally with numbers of rivals, and this is consistent with the predictions of, for example, Weiss [33] and the 1930s' observations of Means [18], [19]. Alternatively, excluding the group of monopolists, the incidence of price raising when demand strengthens generally increases with numbers of rivals, and this gives some support to Weiss but runs counter to the 1959 position developed by Means [20]. Although they predict differing price outcomes during periods when demand is buoyant, both writers predict that administered prices will be more downwardly rigid than market-dominated prices when demand weakens and that administered prices are at least a partial function of market power. This is where the current data are confusing. The incidence of upward and downward price flexibility in the face of, respectively, increases and decreases in demand rises generally with numbers employed (with the partial exception of the largest firms). Moreover, as noted, the incidence of total upward price adjustment generally increases with firm size; by number of rivals it is marginally highest among the possible oligopolists, and this supports Means' 1959 statements but contests the opinions of Weiss. Conversely, similar sequences obtain for the total incidence of price reductions, and this argues against both versions of the hypothesis.

Finally, the extent of pricing flexibility reported in the whole series of papers increases markedly with firm size (declining a little among the largest employers), and it is moderately greater among the possible oligopolists than the other groupings by number of competitors. This militates against the contention that price rigidity is a function of market power and to differing degrees it disputes the views of both Weiss and Means. Although there is a substantial prevalence of price inflexibility in the face of demand variations, on balance, if the findings of this paper (series) are at all meaningful in the context of the administered price hypothesis, they would seem to cast some doubt upon its validity. However, the writer's opinion is that the data are not really suited to a sophisticated analysis in the context of administered prices. For example, the data are not of a time series nature and nothing is known about the amplitude of demand and price changes or about how these magnitudes vary among the groups of respondents. Nothing is known about the question of long- or short-term intervals between demand and price changes, and nothing is known about the interrelationships which might obtain among some of the contingencies and the kinds of price reactions these may induce.

Summary and Conclusions

This article confirms that the substantial pricing (and now non-price marketing) flexibility reported in [28] is a result of the firms trying to come to terms with the severely adverse environment in which they were operating during and before the time of the survey. The findings indicate a widespread tendency for the firms to implement compensatory or servile price and non-price adjustments when the conditions of extended rivalry tighten and, generally to a smaller extent, for them to exploit opportunities when those conditions relax. Overall, cited price and non-price adaptations are extensive, some of the individual contingencies provoke reactions from large proportions of the respondents, some contingencies induce joint price and non-price responses from sizable minorities of the sample, and, when setting prices, most of the respondents take full account of the likely effects of and on their non-price activities. However, some firms do not always consider the links between price and non-price variables; only an increase in costs causes (not quite) all of them to respond, few of the firms react to some of the contingencies, and none of them is responsive to every one or even to most of the contingencies. Explanations have been offered for these observations but the (strong) suspicion of fairly widespread price and non-price marketing myopia cannot be rejected. Price reactions to the contingencies presented were more frequently cited than non-price adaptations, largely because close to one-half of the respondents claimed to be averse to the deintensification of non-price involvement. This reflects an upward ratchet effect on non-price marketing in general which might be a consequence of pressure effusing from customers or established and potential competitors or from the relevant respondents' pessimistic expectations about the future.

The aggregates of each of the four types of reaction vary moderately and consistently but somewhat inexplicably with the degree of sellers' interdependence, and often the frequencies of particular responses to specific contingencies vary irregularly. The monopolists are generally the least flexible marketers, followed by the firms with the most rivals; and responsiveness is most marked in the three groups of possible oligopolists, although among these latter, adaptability increases with the number of rivals. Some explanation for these patterns of variation has been conjectured, although with little conviction in the case of the possible oligopolists. There is some suggestion that oligopoly prices are no less, and perhaps more, flexible than prices in other market structures and predictably, non-price adjustment is more extensive among the possible oligopolists than elsewhere by numbers of competitors. Nevertheless, in accord with the rest of this series, the findings vary further, more systematically and more consistently with numbers employed. For each of the four kinds of reaction the aggregate response increases markedly from the smallest firms to the second largest, but then dips among the largest employers, and this sequence also obtains for many of the specific responses to individual contingencies. Explanations for this were posited in [28] and restated here. Findings in the current article strengthen the possibility conjectured in [28] that the relative rigidity of the largest firms is attributable to their marketing operations being in excess of an optimal size range. There is no doubt however that, among the firms in this sample at least, manufacturers' marketing and competitive policies are influenced far more by matters pertaining to firm size than to the "fewness" or otherwise of rivals. Some implications of this are taken up in [29] where it is shown more comprehensively than it was here, that bigness rather than fewness is associated with substantially the more extensive incidence of price and non-price marketing "followership."

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[1] The rest of the series comprises [26], [28], and [29]. Information about the method, the survey, and the sample was presented in [26] and amplified in [28]. The shortcomings referred to in those two papers continue to apply here. The findings documented in the series were extracted from a more general and continuing study of the international competitiveness of British manufacturing industry.

[2] Numerous previous studies including [9], [10], [12], [14], [16], [21], and [30] have found that prices are sensitive to demand, costs, competitive conditions, and/or new entry. Similar causes of non-price adjustment were reported for example by [1], [2], [13], and [25]. However, most of the previous studies dealt with small samples, some referred to foreign firms, and few attached equal emphasis to both price and non-price adjustment.

[3] Although the respondents were asked to indicate their usual reactions to the contingencies, it appears that some of them might also have cited their anticipated reactions to potential contingencies. For example, 150 respondents claimed that their firms reduce price as a result of reductions in costs but, excluding efficiency gains and exploitation of monopsony power, it is not likely that many of them have encountered this particular contingency for quite some time. Nevertheless, the reference to anticipated reactions is not undesirable since an aim of this article is to identify causes of marketing flexibility, and this is as much indicated by willingness to adjust variables as and when necessary as by actual adjustments.

[4] At the time of the survey, the potential importance of new product substitution in this context was underrated by the writer, and at the time this article was in preparation it was too late to re-contact the respondents.

[5] It was reported in [26] that one-sixth of the firms include price stability as a goal in their sets of pricing objectives.

[6] Although, of course, depending on the nature of their non-price activities, this might be inefficient in welfare terms.

[7] This is true of the frequencies in Table IV. Although breakdowns by the usual groupings are not presented here, the patterns of variation approximate closely to those in Table III at a microcosmic level.

[8] See [26] and [28].

[9] Of the twenty-six monopolists, fifteen indicated that they would react in one way or another to adjustments in the price and/or non-price marketing activities of rivals, and fourteen were contacted by telephone and asked to explain. Ten respondents said that although they encounter no competitors in markets for their leading products, they also produce goods for other markets where rivals are present. Seven said that their earlier postal remarks had been made in connection with potential competitors. One respondent stated that his company was about to diversify into a new product already manufactured by other companies whose competitive efforts would be matched or bettered. Four of the respondents cited both the first and the second explanations.

[10] In this context, it was reported in [28] that the monopolists make the most use of marginal costs and revenues in the pricing process.

[11] Although the effects of successful new entry into markets with many existing sellers will be diffused, it is unreasonable to discount the possibility that some firms at least will attempt to deter new competitors.

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GOVERNMENTAL FINANCIAL REPORTING: MEETING INVESTOR NEEDS

*Gary Giroux and Nicholas G. Apostolou**

The SEC stated in a report on the City of New York that "the most critical deficiency in existing municipal securities practices is in the area of municipal accounting and financial reporting." *Forbes* echoed this criticism in the March 3, 1980, issue with the comment that "shoddy, misleading accounting has not been the cause of our cities' problems but it has prevented us from finding solutions." Ernst & Whinney performed a study of 100 randomly chosen cities, finding that "most municipal finance reports do not provide the complete or clear statement of a city's financial health needed by investors, taxpayers, and even government officials."

Criticism of accounting and reporting practices in the governmental sector has been widespread. This criticism has spurred the interest of the accounting profession in improving these practices so that financial statements will be more relevant and reliable to users of these statements. This heightened interest was reflected in the issuance of the *Statement of Financial Accounting Concepts* No. 4, "Objectives of Financial Reporting by Nonbusiness Organizations" by the Financial Accounting Standards Board in December 1980.

This article provides a background to the developments occurring in the governmental sector by describing the needs of the users of governmental financial statements, the organizations involved in regulating the reporting practices of governmental units, an evaluation of the current quality of financial reporting, and the prospects for improvements to enhance the relevance of municipal financial statements to users. Additionally, the results of a survey to appraise the current state of financial reporting are presented.

User Information Needs

Survey results[1] indicate that major banks are involved in municipal investments for the bank portfolio, underwriting, and investments for trust accounts. The most important categories of information concern outstanding debt level, economic characteristics, and financial characteristics. The relative usefulness of major information items is presented in Table 1. The users surveyed (from 48 banks with assets over $1 billion) indicate that the analysis of debt is of greatest interest, followed by taxation potential. Most of the items deemed important are available from the annual financial statements of governmental units. In addition, 82 percent of the respondents use the financial statements extensively or moderately to evaluate security issues. However, many types of disclosure were considered inadequate by a majority of respondents, including disclosures of restricted assets, commitments and contingencies, explanation of accounting policies, and comparison of budgeted with actual revenues and expenditures.

Table 1
IMPORTANCE OF INFORMATION USED

Information Item	Rank	Mean (4 = Most Important)	Standard Deviation
Total debt outstanding	1	3.833	.377
Debt to actual value ratio	2	3.745	.488
Overlapping debt outstanding	3	3.638	.429
Debt per capita	4	3.630	.532
Tax collection history	5	3.625	.570
Changes in financial position	6	3.596	.614
Population trends, income, etc.	7-8	3.563	.542
Actual value of property in tax jurisdiction	7-8	3.563	.649
Operating revenues	9	3.479	.618
Assessed valuation	10	3.447	.746
Tax rate limits	11	3.435	.620
Operating expenditures	12	3.417	.679
Debt to assessed value ratio	13	3.386	.895
Accounting policies used	14	3.277	.772
Principal taxpayers	15	3.250	.601
Portion of tax rates applicable to debt	16	3.213	.690
Tax rate history	17	3.087	.661
Sinking funds applicable to outstanding debt	18	3.021	.737
Bond rating	19	2.958	.771
Current assets and liabilities	20	2.957	.806
Fixed assets	21	2.333	.853

Source: Boyett and Giroux, p. 30.

Later sections of this article will consider the auditing of financial statements and the significance of federal government regulations. Therefore, users' opinions on these topics are relevant. First, 92 percent of the respondents placed greater reliance on audited financial statements, indicating the importance of CPA opinions to the perception of adequate reporting. Interestingly, 87 percent of the bankers favored changes in federal regulations, and most wanted increased regulations.

Research sponsored by Standard & Poors (S&P) indicates that the market imposes an interest penalty when

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**The authors are, respectively, Associate Professor and Assistant Professor, Department of Accounting, Texas A&M University, College Station, Texas.*

financial statements are substandard. The average extra interest cost may average 0.125 percent to 0.250 percent. About $12 billion of new general obligation bonds are issued annually. Based on S&P's assumptions that half the issuers are in violation of GAAP (generally accepted accounting principles), the total excess interest cost (ultimately borne by taxpayers) may be $75 million to $150 million over the life of the bonds.[2]

The Evidence of Accounting Deficiencies

When considering reporting deficiencies, New York City immediately comes to mind. The attention of the nation has focused on the NYC debacle since 1975. As stated by Robertson:

> New York... had a credit card that enabled it to live beyond its means. For years, its elected officials have had the sort of license that politicians dream about, but that only those at the federal level were presumed to enjoy—namely the opportunity to spend without the concomitant necessity to tax. The set of conditions that led to this unique situation are (1) the unusually liberal borrowing power granted the city by the state and (2) the city's use of budgetary and accounting procedures that even experts find baffling. The second condition helped to conceal the fiscal abuses engendered by the first.[3]

Major abuses during this period included massively growing short-term borrowing ($3.4 billion at the end of fiscal 1974), the recording of major operating expenses under the capital budget (and thus financed by issuing long-term debt), and unrecorded multi-billion dollar pension liabilities. The estimated deficit for 1976 was $1.87 billion (according to GAAP). Interestingly, the 1978 annual report (the year of NYC's first complete audit) reported that according to New York State law, the city achieved a balanced budget for 1978—a $32 million surplus. However, adjustments totaling $744 million were required to be in conformance with GAAP. These were primarily due to expense items still being recorded in the capital budget and additional pension expenses, leaving the city with a $712 million deficit. The financial reports issued by NYC, however, have improved steadily. The 1980 Annual Report states:

> The City has closed the book of discredited financial practices—although New Yorkers will continue to pay for them for many years to come; the budget books to be balanced in accordance with GAAP have been opened one year ahead of schedule.

The city in 1981 was awarded a Certificate of Conformance by the Municipal Finance Officers Association (MFOA), one of only 180 cities receiving this distinction for outstanding financial reporting.

A report by the accounting firm of Coopers & Lybrand[4] revealed that accounting problems extended beyond NYC. Their findings were based on the 1974 annual reports of 46 large cities. Almost 80 percent of the cities did not adequately report pension information, and 33 of the cities had unfunded pension liabilities exceeding $13 billion. Most cities did not properly account for their fixed assets, and a quarter of the cities did not maintain fixed asset records. There were also major deficiencies associated with bond disclosures and overlapping debt, lease obligations, accrued vacation and sick leave, and accounting policies.

The report stated: "The most critical oversight to date has been the failure to separate legal compliance and internal financial reporting to management from external reporting to the public."[5] The recommendations were not just to conform to existing standards of disclosure, but to change accounting and reporting to the standards of commercial accounting, including full accrual accounting, expenses including depreciation, and consolidated reporting.

Three years later another major accounting firm, Ernst & Whinney, reviewed the reporting practices of 100 medium and large cities (based on 1977 annual reports). Their findings were similar to Coopers & Lybrand's, and two major deficiencies were reported:

> 1) The relatively low level of compliance with GAAP in current financial reporting by cities,
> 2) Inadequacies in financial reporting formats and measurement principles that underlie current GAAP for government.[6]

Although most of these large cities had audits by 1977, there were numerous violations of GAAP as was the case in 1974. The recommendations of Ernst & Whinney were much different from those of Coopers & Lybrand. The primary recommendation was compliance with GAAP. In addition, it was recommended that cities issue comprehensive annual financial reports and publish their reports on a more timely basis.

Since New York City's financial problems have come to light, other major cities have suffered near financial collapse. Cleveland was in default on major debt and has had a great deal of difficulty even establishing reliable accounting records. For example, the city's director of finance stated in the 1977 annual financial report: "I join major accounting firms and the State Auditor in their diagnosis of the city's accounting system as inauditable." With a new city administration and the help of their auditors, Cleveland has been attempting to return to financial viability. By 1980 the city received a limited scope (balance sheet) audit, with a complete audit conducted for the 1981 fiscal year.

Chicago is an unusual case since the city has maintained an excellent record of financial disclosure and audited financial statements for many years. However, Chicago has been under a financial strain as have other major cities, including revenue constraints, budget deficits, and substantial unfunded pension liabilities. The financial position of Chicago's Board of Education is not reported in the city's annual report, but has been a significant source of cash flow problems. And so both the school board and the city experienced major liquidity difficulties. The fiscal problems of Chicago demonstrate that seemingly adequate financial disclosure and financial viability are not the same thing. It is interesting to note that the problems of the three cities discussed came to light primarily because their bankers were skeptical of the financial data presented.

Regulating Governmental Reporting

Considering the major problems of municipal financial reporting (and viability), it is little wonder that several organizations have been concerned with regulating governmental accounting. Major organizations with an interest in regulation include the National Council on Governmental Accounting (NCGA), American Institute of Certified Public Accountants (AICPA), Financial Accounting Standard Board (FASB), and at the federal level: Congress, Securities and Exchange Commission (SEC), General Accounting Office (GOA), the Office of Revenue Sharing (ORS), and various other agencies involved in governmental transfer payments to state and local governments. Despite this interest in regulation, the SEC has stated: "The market for municipal securities provides investors only limited protection compared with corporate, (Federal) government, or other types of issuers." This section will review the experience of these organizations and their potential impact in the 1980s.

Prior to the mid-1970s, the NCGA was the only organization actively involved in establishing financial reporting standards for government entities. *Governmental Accounting, Auditing, and Financial Reporting* (GAAFR), published by the NCGA in 1968 and revised in 1980 (based on NCGA Statement Number 1, *Governmental Accounting and Financial Reporting Principles),* has been widely accepted as the major source of GAAP by both municipal accountants and independent CPAs. Because of decades of experience in determining governmental accounting standards and wide acceptance by the accounting profession, the NCGA has been considered the organization best able to establish accounting standards.

Direct involvement by the AICPA has been limited to an audit guide, *Audit of State and Local Governmental Units* (ASLGU) issued in 1974, and a number of Statements of Positions issued since 1975. ASLGU is especially relevant to the preparation of audited financial statements. While there were a few differences between ASLGU and the 1968 GAAFR, GAAFR was recognized by ASLGU as an authoritative source of governmental GAAP. These two organizations are the basic sources of GAAP for state and local governmental accounting.

Although the FASB has had the authority since 1974 to establish GAAP for both profit and nonprofit entities, it has focused on the profit sector.[7] However, since 1978, a project to determine financial accounting objectives for not-for-profit organizations was added to its agenda and an exploratory study was issued.[8] When an exposure draft was issued in 1980, governmental units were excluded from consideration—a major reason being lack of authority to require governmental units to abide by their pronouncements. As stated by the Comptroller General:

> ...state governments have the sovereign right to set their own accounting standards just as the federal government does, and there is doubt that they would accept the FASB's work in the area if it were performed.[9]

However, the final draft (*Statement of Financial Accounting Concepts No. 4,* 1980) stated: "The Board is aware of no persuasive evidence that the objectives in this statement are inappropriate for general purpose financial reports of governmental units" (para. 4).

Thus, the FASB has been considered unacceptable to promulgate governmental GAAP. In addition, the structure of the NCGA has a number of weaknesses: this organization is not independent (being supported by the MFOA); the Council is made up of part-time members; and the funding is inadequate to support major research projects. In 1980 several organizations (including those discussed in this article) formed a Governmental Accounting Standards Board Organization Committee (GASBOC) on the need for a new Government Accounting Standards Board (GASB). The GASBOC Exposure Draft states:

> The structure recommended would have three integral parts: an oversight foundation, a full-time standards-setting board, and an advisory council (p. 1).

The final report of the GASBOC recommended that the Financial Accounting Foundation (FAF), which is the funding and oversight body for the FASB, "assume the initiative to implement" the GASB. The FAF early in 1982 named an advisory committee to develop specific proposals to establish the GASB. This new, independent board should have adequate funding to carry out research and accounting standards. It is not clear at the present time whether the pronouncements of the new board (assuming a GASB will become a reality) will differ appreciably from those of the NCGA.

Congress and various federal agencies are interested in municipal accounting for two basic reasons. The first is federal jurisdiction (primarily by the SEC) over the securities markets, although municipal bonds have been exempt from most regulations. Since 1975, the Senate Banking Subcommittee on Securities has held numerous hearings on municipal bond activities and various pieces of legislation have been proposed to provide greater federal control (such as the Municipal Securities Full Disclosure Act). The crux of the proposed legislation would have required the submission of audited annual reports to the SEC by the larger municipal bond issuers, with the annual reports having to conform to SEC requirements. The proposed legislation never got beyond the Senate Banking Committee.

The second area of federal interest involves federal government transfer payments. The disbursement of billions of dollars of revenue sharing and categorical grants suggests the need for federal regulation over financial accounting and reporting of state and local government units. The State and Local Fiscal Assistance Amendments of 1976 (authorizing annual revenue sharing of $6.85 billion from 1977-80) listed a number of accounting requirements. From the perspective of consistently-applied GAAP, the most important requirement has been for an independent audit (by CPAs, state auditors, or local auditors) for recipients receiving $25,000 or more in annual entitlements to determine legal compliance with the Act. This legislation represents the first nation-wide requirement for government units to conform to established GAAP, with all states and approximately 11,000 local governments subject to the audit requirements. Revenue sharing was reauthorized in 1980, but without any substantial changes in accounting regulations.

More recently, the State and Local Government Accounting and Financial Reporting Standards Act was introduced in the Senate to standardize municipal accounting. The bill would establish an "Institute for State and Local Accounting and Financial Reporting Standards" to promulgate accounting standards. If the bill were to become law, it would establish a body unique within the accounting profession. The "Institute" would have the force of federal law behind it, as does the SEC, and would have an independent board of seven members selected by a separate "council," similar to the FASB. Yet this institute would not have the broad perspective of either body. Its purpose would be limited (as, for example, the Cost Accounting Standards Board had limited functions), in this case, to state and local governmental GAAP. In some form, Congress may yet grant authority to a rule-making body over municipal accounting standards. However, because of the formation of a new GASB in the private sector it is presumed that Congress will not establish this proposed "Institute."

An interesting development has been the formalization of an accounting policy by S&P in 1980 that they would reject applications and lower or withdraw ratings of municipalities with inadequate financial reporting. According to S&P, the ratings process involves the timely receipt of audited financial statements prepared in accordance with GAAP. Examples cited by S&P include: (1) San Francisco, whose bond rating was temporarily withdrawn because of the lack of timely reporting; (2) Massachusetts and Toledo, where the bond ratings were downgraded partly because of poor accounting; and (3) reporting weaknesses by New York State and Puerto Rico.

The Recent Evidence

For purposes of analysis, the latest annual reports were requested from approximately 500 cities. A stratified random sample of cities was used based upon the cities listed in *The Municipal Year Book 1979* (International City Management Association, 1979). A request was sent to all cities with a population over 250,000; half of all cities with a population between 100,000 and 249,999; a quarter of those between 50,000 and 99,999; and about 7 percent of those with populations below 50,000. Annual reports from 1979 and 1980 were received from 50 percent of the cities (the response was particularly low from cities with populations below 10,000—about 15 percent).

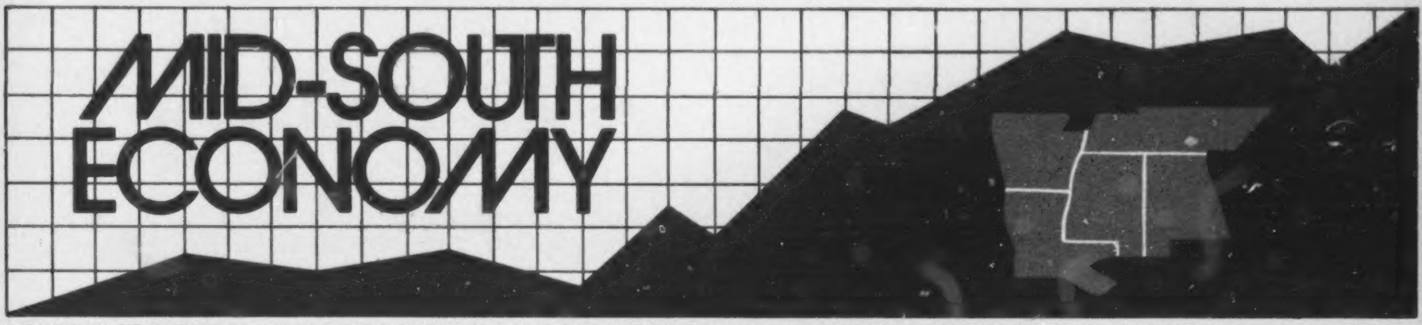
The results from the review of 250 annual reports received are presented in Table 2. Most of the cities were relatively small, and 24 percent had populations below 10,000. As expected, results varied somewhat by size group. Thus, while 86 percent of the cities with populations over 50,000 indicated an audit, only 64 percent with populations below 50,000 reported audits. Overall, 78 percent of the cities had an audit, whether large or small. All the Michigan cities in the sample with a population exceeding 5,000 were audited. Of these nine cities, five received unqualified opinions. The only surprise was that 100 percent of all but the small cities (say, those in Group D) were not audited because of the revenue sharing requirements. Although the federal regulations require an audit only once every three years, and the audit requirements can be waived by the Office of Revenue Sharing, at least a few of these cities may be in violation of federal requirements.

Table 2
AUDIT RESULTS OF AMERICAN CITIES BASED ON 1979-1980 AUDIT REPORTS

Population Size Categories	Population Group	All Cities	Annual Reports Reviewed	How Many Reported Audits?	National CPA Firm	By Whom? Local CPA Firm	Governmental Auditors	Number of Qualified Opinions
250,000 +	A	58	43	42	33	3	6	32
50,000-249,999	B	362	79	63	30	32	1	27
10,000-49,999	C	2,060	67	50	13	37	0	29
Below 10,000	D	4,209	61	39	3	31	5	24
Totals		6,689	250	194	79	103	12	112

Interestingly, non-audited cities appear in certain states, for example, Indiana, Massachusetts, New Hampshire, New Jersey, New York, Ohio, Pennsylvania, and Washington. At the same time, all cities in the sample from several states were audited including Florida, Louisiana, Maine, and Minnesota. This suggests that state requirements for audits have played a major factor in municipal auditing and reporting.

The type of audit firm varied by city size, as expected. The large cities were invariably audited by national CPA firms, especially the "Big Eight." Of the 36 cities in Group A audited by CPAs, 33 (92 percent) were audited by national firms. At the other end of the scale, 31 (91 percent) of the CPA audits of Group D cities were conducted by local firms. This correlation with firm size is similar to that of commercial firms' audits. Since the local CPA firm may have no in-house expertise in governmental auditing, these results suggest an increasing need for continuing professional education (CPE) in this area. Government auditors also conducted municipal audits; however, only 12 (5 percent) were conducted by this group. City size seems to have little to do with whether a governmental auditor is utilized rather than a CPA; however, governmental audits are congregated in certain states (e.g., Maryland, Massachusetts, Minnesota, Ohio).



MID-SOUTH ECONOMY

BUREAU OF BUSINESS & ECONOMIC RESEARCH THE FOGELMAN COLLEGE OF BUSINESS AND ECONOMICS MEMPHIS STATE UNIVERSITY

STATISTICAL SUPPLEMENT

MID-SOUTH ECONOMY

Recent economic data offer evidence that a recovery phase is underway and has begun to broaden its base. The Composite Index of Leading Indicators continues to point to a sustainable expansion with a 1.1 percent increase in April 1983, marking its tenth straight monthly rise. The nation's real Gross National Product grew 2.6 percent in the first quarter of 1983 compared with a 5.1 percent decline in the first quarter of 1982. Consumer confidence has dramatically improved as a result of rising job expectations and gains in real income due to lower inflation. Business confidence has also picked up with improving orders, production, and capacity utilization. This greater willingness and ability to spend is generating higher retail sales and home buying in the face of still relatively high real borrowing cost.

Even though most economic observers indicate that this recovery phase can be expected to continue at a reasonably comfortable pace, there are potential roadblocks. The expansion has not broadened and deepened enough to reach either capital investment or the labor market. Also, the prospects of large federal budget deficits in future years and prospects for deficits in the nation's merchandise trade balance are factors which will cause the financial markets to remain apprehensive. The current high value of the American dollar in international currency markets is expected to limit exports and worsen the trade deficit as spending on imports rises along with gains in consumer incomes.

All of the national indicators of sustainable recovery notwithstanding, the Mid-South continues to face painfully high unemployment and a weakened farm economy. Average farm real estate values for the five Mid-South states declined 5.9 percent in April 1983 compared with April 1982. The current payment-in-kind (PIK) program has approximately 3.2 million acres of Mid-South farm land out of production. This is expected to halt the slide in the value of farm assets, increase farm incomes, and reduce the demand for farm credit. However, the program will have mixed results because of the negative impact on farm equipment, fertilizer, and chemical sales. The Mid-South aggregate unemployment rate stands at an unadjusted 11.7 percent for April 1983 compared with 10.7 percent last April and 7.6 percent in April 1981. However, this is substantially below the January 1983 rate of 13.2 percent. Elsewhere, sales tax collections continue to register healthy gains along with residential construction activity. And, Mid-South savings and loans continue to rebound from their levels of a year ago.

Labor

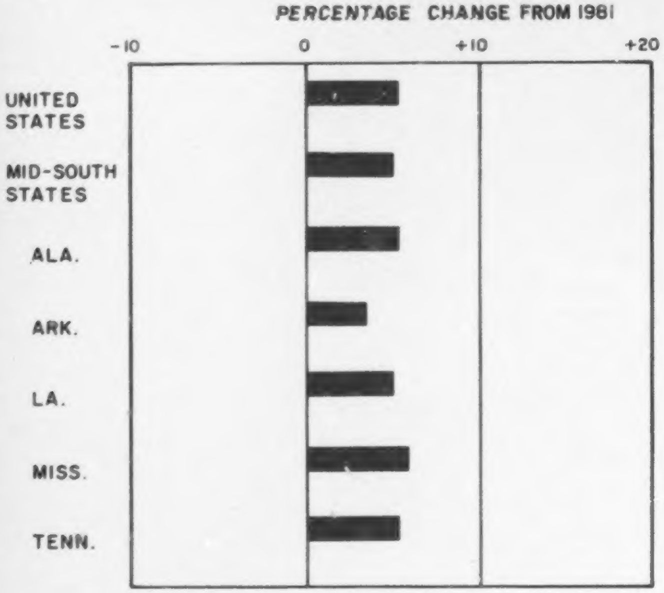
The Mid-South civilian labor force totaled 7,770,000 in April 1983, up only 0.8 percent from last April. The total number of unemployed persons increased 10.6 percent to total 912,400. This pushed the aggregate unemployment 1.0 percent higher than this time last year. Manufacturing employment had 69,200 fewer jobs than last April, a decline of 4.8 percent. Non-manufacturing employment in the Mid-South registered a decline of 1.5 percent from the level of a year ago, representing some 73,200 fewer jobs.

Average weekly earnings for production workers registered strong gains in Arkansas, Tennessee, and Mississippi, outpacing the national increase of 5.9 percent. Another sign of improvement in the manufacturing sector is evident by the gains in average weekly hours worked. Four of the five Mid-South states outperformed the national increase of 1.3 percent. Louisiana's employment situation, after being the star performer in the Mid-South during 1982, experienced a 31.4 percent increase in the number of persons unemployed and a 7.9 percent decline in the number of manufacturing jobs.

Construction

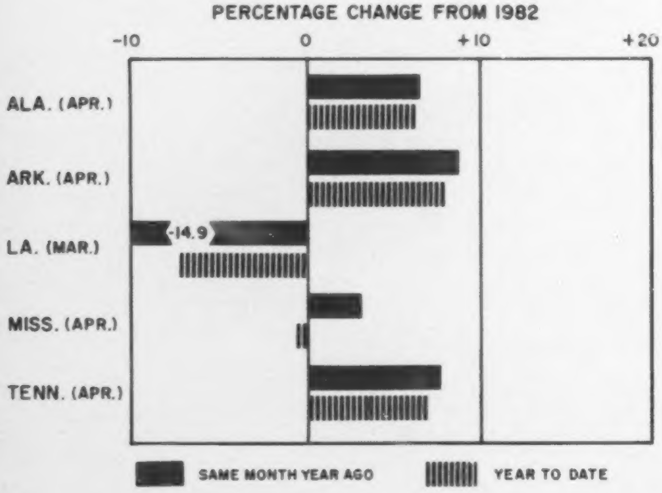
For the twelve-month period ending March 1983 total building activity in the nation increased 0.3 percent compared with the same period in 1982. Residential building activity registered a 20.7 percent increase, while non-residential building declined 14.5 percent. Continued improvement in the residential sector is indicated by the 24.2 percent increase in the number of dwelling unit permits issued across the nation. Most of the Mid-South states

PERSONAL INCOME - IV QTR. 1982

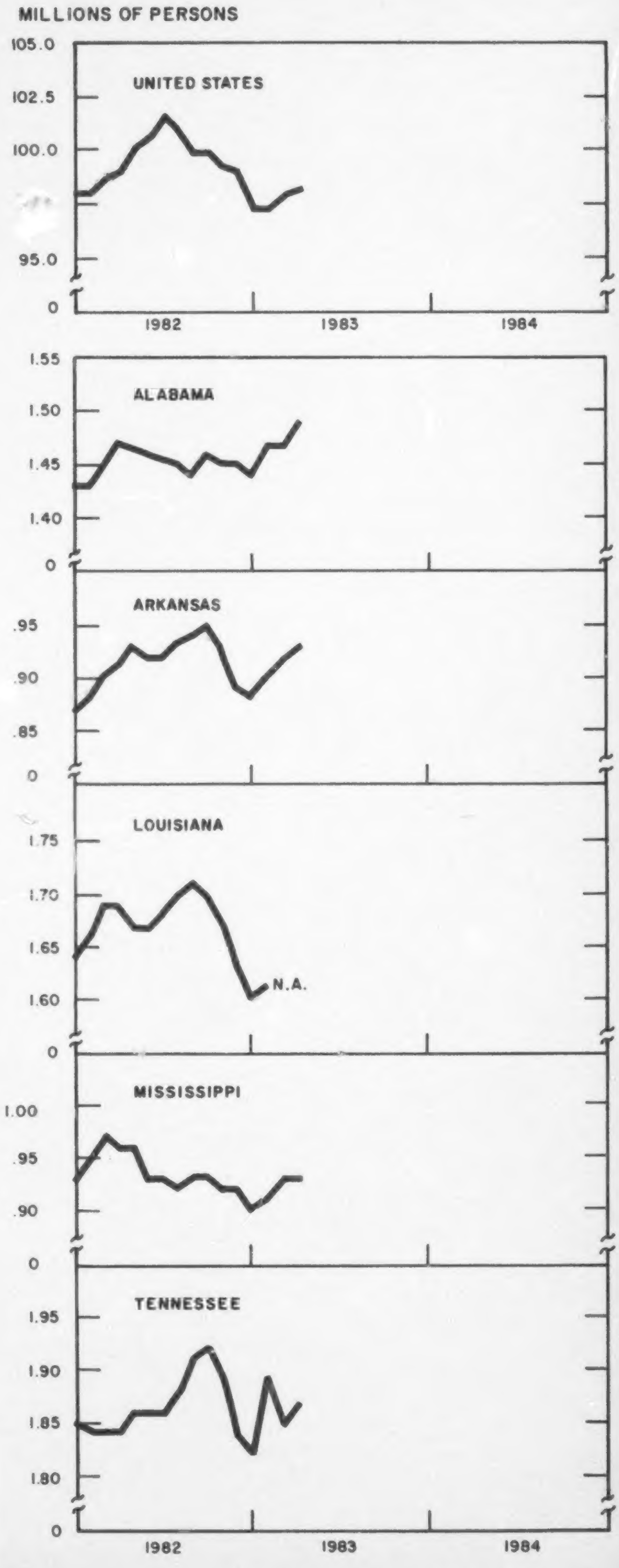


SOURCE: BUREAU ECONOMIC ANALYSIS

SALES TAX COLLECTIONS 1983



TOTAL EMPLOYMENT



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experienced substantial gains in residential building activity and the number of dwelling unit permits issued. Louisiana was the only Mid-South state to register an increase in non-residential building activity, primarily due to the construction of new hospitals and schools.

Finance

The rebound in residential building activity is reflected in the mortgage lending activity of Mid-South savings and loans. Total mortgage loans made were 191.5 percent higher in March 1983 than in March 1982. Net savings flow activity also has experienced a healthy turnaround from its levels of a year ago. This propensity to save more is also apparent in United States and Mid-South commercial banking data where savings deposits registered gains of 113.2 and 96.3 percent, respectively.

The June 22, 1983, issue of the *American Banker* ranked commercial banks in four categories of lending. The following list profiles the top Mid-South banks in each category along with their national ranking in parenthesis. Consumer: First National Bank of Birmingham (94th); Agricultural: Deposit Guaranty National Bank in Jackson, Mississippi (46th); Foreign: First Tennessee Bank in Memphis (88th); Commercial and Industrial: Whitney National Bank in New Orleans (91st).

LABOR 1983	United States (March)	Mid-South States				
		Alabama (April)	Arkansas (April)	Louisiana (April)	Mississippi (April)	Tennessee (April)
Civilian Labor Force Percent Change Year Ago	109,873,000 +1.0	1,729,800 +1.8	1,018,000 +0.2	1,843,300 +0.4	1,052,500 -0.4	2,126,400 -0.1
Unemployed Percent Change Year Ago	11,879,000 +15.4	234,100 +5.0	89,900 -3.1	219,300 +31.4	119,500 +7.0	249,600 +5.9
Unemployment Rate	10.8	13.5	8.8	11.9	11.4	11.7
1981						
1980	9.2	13.1	9.1	9.1	10.6	11.1
Non-Agricultural Wage & Salary Employees Percent Change Year Ago	88,240,000 -1.6	1,309,200 -1.3	728,600 +0.5	1,590,200 -2.1	787,500 -1.5	1,663,300 -2.6
Manufacturing Employment Percent Change Year Ago	18,263,000* -5.5	328,800 -4.8	197,700 -0.4	191,700 -7.9	197,400 -3.5	467,800 -3.0
Non-Manufacturing Employment Percent Change Year Ago	70,591,000* -0.5	980,400 -0.1	530,900 +0.8	1,398,500 -1.2	590,100 -0.8	1,205,500 -2.5
Average Weekly Earnings of Production Workers in Manufacturing Percent Change Year Ago	$346.50 +5.9	$303.91 +5.5	$275.52 +8.2	$387.25 +0.9	$261.89 +6.3	$296.06 +9.1
Average Weekly Hours of Production Workers in Manufacturing Percent Change Year Ago	39.6 +1.3	40.2 +2.8	39.7 +2.6	38.8 +0.5	39.5 +2.3	39.9 +4.7
Average Hourly Earnings of Production Workers in Manufacturing Percent Change Year Ago	$8.75 +4.5	$7.56 +2.6	$6.94 +5.5	$9.73 +3.9	$6.63 +3.9	$7.42 +4.2

*Seasonally adjusted.

Source: Departments of Employment Security and Survey of Current Business.

CONSTRUCTION[1]	March 1983	United States	Alabama	Arkansas	Louisiana	Mississippi	Tennessee
Total Building Percent Change Year Ago		+ 0.3	- 5.8	N.A.	+22.7	+18.9	+ 3.1
Residential Building Percent Change Year Ago		+20.7	+ 1.9	N.A.	+30.7	+43.4	+43.4
Non-Residential Building Percent Change Year Ago		-14.5	-10.7	N.A.	+17.6	- 1.7	-18.5
Total Dwelling Unit Percent Change Year Ago		+24.2	+ 4.1	N.A.	+32.9	+32.6	+39.5

[1] Twelve-month cumulative rate.

Source: Federal Reserve Bank of Atlanta from data supplied by the Bureau of Census.

FINANCE April 1983	United States	Mid-South States	Alabama	Arkansas	Louisiana	Mississippi	Tennessee
Member Banks as of 4/6/83 Percent Change from Comparable Date 1982							
Total Deposits	+ 12.1	+ 9.0	+ 7.1	+19.8	+ 2.8	+ 11.7	+ 12.8
Demand Deposits	+ 2.7	+ 1.0	+ 3.8	+14.1	- 2.7	+ 1.5	+ 0.9
Time Deposits	- 9.7	- 3.6	- 8.5	+ 8.8	- 0.1	- 7.6	- 10.0
Savings Deposits	+113.2	+96.3	+89.0	+21.7	+97.8	+119.6	+136.9

Source: The Federal Reserve Bank of St. Louis and the Federal Reserve Bank of Atlanta.

SAVINGS AND LOAN ACTIVITY March 1983	Alabama	Arkansas	Louisiana	Mississippi	Tennessee[1]
Mortgage Loans Made (millions)	$ 60.5	$182.7	$153.1	$ 29.4	$ 44.3
Percent Change Year Ago	+178.8	+332.9	+132.3	+203.9	+103.6
Percent Change Year-to-Date	+226.2	+347.4	+126.4	+187.3	+131.4
Net Savings Flow (millions)[2]	$102.1	$183.8	$244.3	$ 42.0	$131.2
Percent Change Year Ago	+167.3	+496.7	+124.1	+ 47.9	+132.5
Percent Change Year-to-Date	+253.8	+1364.8	+218.7	+214.2	+383.8

[1] Figures are for total loans made.

[2] Net savings flow equals new savings received plus dividends credited minus savings withdrawn.

Source: Federal Home Loan Banks of Little Rock, Cincinnati, and Atlanta.

TENNESSEE ECONOMY

Tennessee's economic performance at the end of the first quarter of 1983 provided the basis for optimism but also contained some rather discouraging news. The good news included the fact that for the twelve months ending March 1983 the dollar value of residential permits increased 43.4 percent from the corresponding period in 1982. Retail sales increased 6.4 percent in the first quarter of 1983 compared with a national increase of 5.3 percent. And, the Tennessee Department of Economic and Community Development reported 15 new plants and 21 expansions valued at $317.7 million undertaken during the first quarter of 1983. However, unemployment stood at an unadjusted 11.7 percent of the work force, with manufacturing employment 3.0 percent below its April 1982 level. Non-residential construction activity declined 18.5 percent for the twelve months ending March 1983 versus the same period of 1982, primarily in the office and industrial building sector. The average value per acre of farm land and buildings declined 5.0 percent from its April 1982 level.

There are encouraging signs for the metropolitan area of the state, but many rural counties remain hard pressed as exemplified by a 37.1 percent unemployment rate for Stewart County. For the state as a whole, 78 counties registered declines in their unemployment rates, while 17 counties registered increases. Chattanooga, Memphis, and the Tri-Cities area registered gains in total non-agricultural employment in the first quarter of 1983 versus fourth quarter 1982. Retail sales also registered dramatic gains in all the metropolitan areas except Knoxville. These gains in retail sales across the state are showing up in sales tax collections which are up 6.7 percent for the first four months of 1983 compared with the same 1982 period.

Agriculture and tourism are two key areas of concern. After the closing of the Knoxville World's Fair, any improvements in tourism will be tied to an improving national economy, while the prospects for agriculture rest in the payment-in-kind program (PIK) and to some extent the world market for agricultural products. Currently, 694,000 acres are enrolled in one of the four PIK programs, but this is expected to produce mixed results and could eventually slow economic activity in the rural areas by reducing local incomes due to the decline in purchases of equipment, fertilizer, and chemicals. And, with the high value of the dollar in the international currency markets, Tennessee farmers may have difficulty registering any substantial gain over the $590 million worth of agricultural exports achieved in 1982.

The following are selected business-related, legislative public acts enacted during the first session of the 93rd Tennessee General Assembly which adjourned May 12, 1983: *Chapter 213* - Enacts the "Buy America Act" relative to purchases of certain materials by state, county, and municipal governments; *Chapter 203* - Imposes a tax on the use of liquefied petroleum gas for the propulsion of a motor vehicle; *Chapter 415* - Provides for payment and collection of certain taxes on the retail occupants of antique malls, flea markets, craft shows, gun shows, and auto shows; *Chapter 234* - Provides that the 17.0 percent wholesale beer tax shall not apply to any new increase in the state or federal per barrel privilege tax; *Chapter 127* - Changes provisions for property tax relief for elderly or disabled taxpayers by increasing the annual income limit to $12,000.

Unlike commercial firms, a qualified opinion is common for municipalities. Of the 194 cities with an auditor's report, 58 percent had one or more exceptions. Over 56 percent of the cities of over 50,000 in population had exceptions, and the exception rate was somewhat larger for smaller cities. Cities below 50,000 had an exception rate of about 60 percent. Despite these "dismal" findings, these results indicate improvements in accounting procedures from earlier years.

Conclusion

In this article, the recent developments that impact governmental accounting and reporting were discussed. Criticism of accounting practices in the governmental sector has been widespread. However, the efforts of governmental and rating agencies, as well as the accounting profession, are spurring improvements that will lead to statements more relevant to users. Accountants need to be aware of these developments to effect an orderly, systematic transition to new reporting models.

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[1] For a complete review of the results of a recent survey, see Arthur S. Boyett and Gary A. Giroux, "The Relevance of Municipal Financial Reporting to Municipal Security Decisions," *Governmental Finance*, May 1978, pp. 29-34.

[2] "Who's Watching the Books?" *Perspective*, Standard & Poors, 1980, p. 3.

[3] Wyndham Robertson, "Going Broke the New York Way," *Fortune*, Vol. 92, No. 2, 1975, p. 144.

[4] Coopers & Lybrand and the University of Michigan, *Disclosure Practices of the American Cities*, Coopers & Lybrand, 1976.

[5] *Ibid.*, p. 7.

[6] Ernst & Whinney, *How Cities Can Improve Their Financial Reporting*, Ernst & Whinney, 1979.

[7] It should be noted that several FASB pronouncements and those of predecessor bodies can be applied to governmental units, such as those involving leases, pensions, accounting policies, receivables, and payables.

[8] Robert N. Anthony, *Financial Accounting in Nonbusiness Organizations*, FASB, 1978.

[9] Elmer B. Stats, "The NCGA Has the Experience and Support," *The Journal of Accountancy*, March 1979, p. 70.

CONSUMER PERCEPTIONS OF MEMPHIS SHOPPING CENTERS AND THEIR EFFECTS ON SHOPPING BEHAVIOR

*Peter K. Tat and John R. Thompson**

Introduction

For many years, the literature of marketing has been replete with articles reporting on studies of consumer perceptions of the image of retail stores (6,7,10,11). Consumers are believed to patronize stores that they see as reflections of their own self-image (2,1,12). The way a customer "sees" herself will affect the stores patronized by that consumer.

Among the earliest articles on store image was one by the late Pierre Martineau who stated that there was some force called the store's personality or image—the way in which a store is defined in the customer's mind (7). Many different intangible traits constitute a store's personality: store layout and display, sales personnel, advertising, service and store reputation. Retailers must be concerned with the more concrete factors of location, price, and merchandise, but nevertheless many intangible features play a crucial role in attracting customers to particular stores.

In keeping with their different personalities, stores attract different types of clientele; women may choose the type of store whose overall image best fits the image they hold of themselves. Women who identify themselves with different social classes, for instance, may choose to shop at stores of differing status from others. Martineau concluded that "... there is no such thing as a store image with equal appeal for all income groups, all social classes, all ages, all types" (7). It was the downtown stores to which Martineau gave most of his attention. However, referring to the expansion of suburban branches, he also noted that branch stores took on the personality and character of the big downtown store, even though quite different in appearance and merchandise offerings from the parent store.

Later studies have expanded on these notions to further understand why consumers are attracted to particular stores and repelled by others. There does not appear to be universal agreement as to precisely what is meant by the intangible expression "store image." However it has been defined, image has usually included such definitional criteria as merchandise price, quality, assortment, sales personnel, location, convenience, services, advertising, store atmosphere, and adjustment policies. Consumer perception of these factors, however learned, constitutes retail store image.

As marketers sought to determine the image of retail outlets, changes continued in the institutions of retailing which compounded the measurement problem. A significant change in the structure of retailing in the post-WWII period has been the growth at the planned shopping centers in the suburban areas of metropolitan locations as well as in smaller cities.

Retailers in Memphis saw major changes taking place in their markets too, and developers were not long in pursuing national trends with the opening of a large regional mall—Southland Mall—in 1966. An even larger mall, Raleigh Springs Mall, followed so that throughout the decade of the seventies, Memphis was a two-mall city, with an added array of usual types at shopping areas. By late 1981 two additional planned centers opened which had the strength to modify shopping patterns. It was the latter development which prompted this study of consumer perceptions of the shopping centers and resultant changes in shopping behavior.

Methodology

The sample for this project consisted of the members of the household panel developed for the Memphis State University Bureau of Business and Economic Research. A total of 396 questionnaires were mailed to panel members. To increase panel members' willingness to respond, a $1.00 bill was included with the questionnaire. Responses were received from 283 panel units for a response rate of 71.5 percent.

The questionnaire consisted of three sections of which the first was a series of questions regarding shopping behavior. In addition, shopping patterns before and after the opening of the new malls were examined to detect any change in patronage behavior due to competition from the new malls.

The second section contained the semantic differential which was used to measure consumers' perceptions of the four major shopping centers in Memphis: Southland Mall, Raleigh Springs Mall, Hickory Ridge Mall, and the Mall of Memphis. The semantic differential possesses advantages of image measurement, ease in administration, provision of quantifiable data, minimal verbal skill requirements, and reasonably high reliability (3). Twenty-two items were included in the semantic differential which were designed to measure the quality of the center, pres-

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**The authors are, respectively, Assistant Professor of Marketing and Professor of Marketing, Memphis State University, Memphis, Tennessee.*

ence of related services, variety under one roof, and convenience. The items were selected for inclusion in the semantic differential after extensive literature reviews and a pretest of their relative importance, using shoppers at the four malls. The positive and negative aspects of these items were placed randomly at the right and left side of the semantic differential to avoid the halo effect of position bias.

Section three sought demographic data from the panel members. These variables were analyzed to detect any relationship between demographic characteristics and shopping center patronage behavior.

Demographic Characteristics of the Household Panel

As shown in Table 1, one-fifth of the respondents of the household panel had an annual family income of over $40,000, and less than one-third had an income of under $20,000 per year. This is perhaps attributed to the educational attainment, employment of the spouse, and high occupational status of the panel members. While two-thirds of the respondents had at least some college, 23.5 percent were college graduates, and 20.6 percent had postgraduate education. Moreover, more than 47.0 percent of the respondents were in professional or managerial positions, and 45.5 percent indicated that their spouse was also employed.

Table 1

DEMOGRAPHIC CHARACTERISTICS OF THE RESPONDENTS

Marital Status	
Single	15.4%
Married	65.6
Divorced	15.1
Widowed	3.9
Sex of the Head of the Family	
Male	75.0
Female	25.0
Race of the Head of the Family	
White	91.4
Black	8.6
Size of the Family	
One	21.7
Two	28.1
Three	19.6
Four	20.6
Five	6.8
More than Five	3.2
Educational Attainment of the Head of the Family	
Some High School or Less	4.6
High School Graduate	19.9
Some College	31.3
College Graduate	23.5
Post Graduate	20.6
Occupation of the Head of the Family	
Professional or Managerial	47.5
Sales or Clerical	16.5
Craftsman/Factory Worker	10.1
Service Worker	4.0
Self-Employed	5.0
Retired	14.7
Other	3.2
Family Income in 1981	
Under $10,000	7.2
$10,000 to $14,999	10.8
$15,000 to $19,999	14.0
$20,000 to $24,999	14.7
$25,000 to $29,999	12.2
$30,000 to $34,999	12.5
$35,000 to $39,000	8.6
Over $40,000	20.1
Employment of Spouse	
Yes	45.5
No	54.5

In terms of marital status, 65.6 percent were married; and 15.4 percent, 15.1 percent, and 3.9 percent were single, divorced, and widowed, respectively. The percentage of reported size of the household was 21.7, 28.1, 19.6, 20.6, 6.8, and 3.2 for family size of 1, 2, 3, 4, 5, and more than 5, respectively, with an average of 2.7 per household.

Memphis Shoppers' Perceptions of the Major Planned Shopping Centers

The household panel members were asked to rate the salient attributes of the four major planned shopping centers in Memphis: Mall of Memphis, Raleigh Springs Mall, Southland Mall, and Hickory Ridge Mall. The semantic differential was used for this purpose. As can be seen from Figure 1, the overall perceptions of the important attributes of the four malls by the respondents were favorable. Hickory Ridge Mall and Mall of Memphis were perceived as being cleaner and having more attractive decors than Raleigh Springs Mall and Southland Mall. However, the respondents indicated they can find the stores they want more easily in Raleigh Springs Mall than they can in the other three malls.

In terms of convenience of reaching the center, Mall of Memphis had higher ratings than the other three malls. Respondents in this study perceived that it is not as easy for them to find parking spaces at Southland Mall as it is at the other malls.

The Mall of Memphis and Hickory Ridge Mall were regarded as having a wider selection of different kinds of stores and more high quality stores than the other two malls. However, Raleigh Springs Mall was seen by the respondents as having more well known stores.

As far as prices were concerned, the stores in Raleigh Springs Mall were believed to charge slightly lower prices, offer more values for the money spent, and have a larger number of items specially priced than the other three malls. The stores in the two new malls were seen as not offering low prices for their merchandise.

Advertising by the stores in the four malls was perceived as helpful in planning purchases, appealing, believable, and frequently seen by the respondents. However, the respondents could not determine if they had seen frequent advertising by the stores in Southland Mall.

All four malls were well known to, and liked by friends of the respondents. Except for Southland Mall, all of the malls were recommended and shopped at by friends of the respondents.

Mall Shopping Behavior

Mall shopping behavior in this study included shopping activities, number of hours spent at the mall, the usual day of the week spent on mall shopping, the usual time of the day spent on mall shopping, shopping frequency, and shopping companionship. The findings of mall shopping behavior are presented in Tables 2 and 3.

FIGURE I

Semantic Profile of Major Memphis Shopping Malls

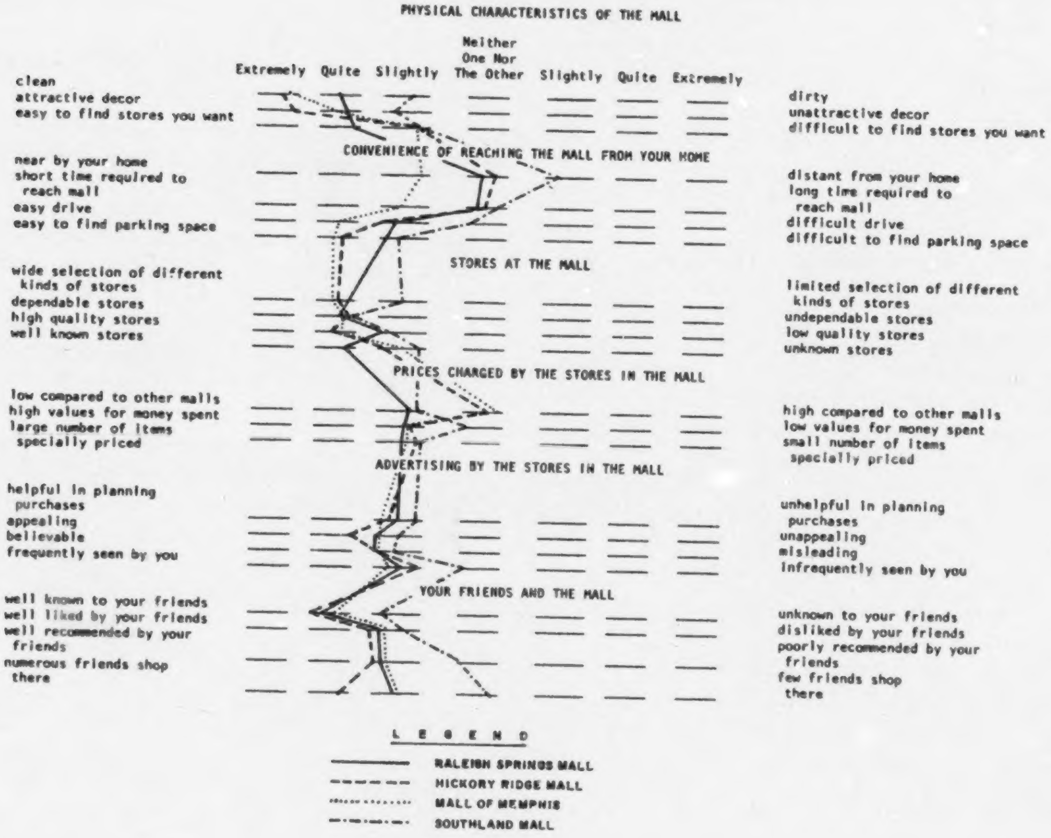

Table 2

SHOPPING ACTIVITIES OF THE LAST SHOPPING TRIP

Shopped (Made a Purchase)	81.3%
Window Shopped	64.7
Shopped (Browsed in Stores)	27.9
Ate Lunch	21.2
Saw Exhibits	15.2
Saw Movies	14.8
Ate Dinner	14.1
Played Video Games	4.9
Went to Bank	4.2
Went to Barber Shop	1.8
Went to Beauty Shop	1.1
Saw Fashion Show	0.7
Other	5.3

Table 3

SELECTED MALL SHOPPING BEHAVIOR

Number of Hours Spent at the Mall	
Less than One Hour	22.3%
One to Two Hours	35.8
Two to Three Hours	30 [illegible]
Three to Four Hours	8.[illegible]
Four to Five Hours	2.1
More than Five Hours	1.1
Shopping Frequency	
Less than Once a Month	25.4
Once a Month	16.4
Two to Three Times a Month	44.3
Once a Week	11.8
More than Once a Week	2.1
Time of the Day	
Morning	18.1
Afternoon	42.6
Evening	38.7
Shopping Companionship	
Shopped Alone	26.6
With Spouse	30.9
With Children	9.2
With Family	19.2
With Friends/Neighbors	12.1
With Co-Workers	0.4

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Since, throughout the years, shoppers have had different motives for shopping trips, with motives varying from trip to trip, this study asked the respondents to indicate the shopping activities of their last shopping trip. As can be seen from Table 2, out of the 12 shopping activities, the most popular activity was making a purchase (83.3 percent), followed by window shopping (64.7 percent), browsing (27.9 percent), eating lunch (21.1 percent), seeing exhibits (15.2 percent), seeing movies (14.8 percent), eating dinner (14.1 percent), playing video games (4.9 percent), going to the bank (4.2 percent), going to barber shop (1.8 percent), going to beauty shop (1.1 percent), and seeing fashion show (0.7 percent).

A typical shopping trip lasted for less than three hours (see Table 3), with one to two hours as the most mentioned time spent on a shopping trip. Only 1.1 percent of the respondents spent more than five hours at the mall on their last shopping trip. Afternoon was the favorite time of the day for shopping at the mall, with 42.6 percent of the respondents indicating this was the usual time of the day they shopped. Almost half of the respondents shopped two to three times a month at major shopping centers. Less than 15.0 percent indicated they shopped at least once a week. Saturday was the usual day for shopping. Other than Saturday, there was no usual day for mall shopping.

Shopping appears to be a family affair; the majority of the respondents shopped with their family members. Less than 13.0 percent shopped with someone outside of the family, and about one-fourth went shopping alone.

Shopping Patterns Before and After the Opening of the New Malls

To examine the effect of the opening of the new malls on Memphis shoppers' shopping patterns, the respondents were asked to indicate the mall at which they shopped most frequently before and after the opening of the new malls. The results are shown in Table 4. Before the opening of the new malls, Raleigh Springs Mall was the favorite mall among the respondents as 62.5 percent indicated this was the mall they shopped most frequently in 1980 and 1981. However, this percentage dropped significantly to 35.7 percent after the new malls were opened. Nevertheless, Raleigh Springs Mall is still the mall that is frequented most by the respondents. The percentage of respondents indicating the mall they shopped most frequently in 1982 was 27.6, 18.8, 14.3, and 3.6 for the Mall of Memphis, Hickory Ridge Mall, Southland Mall, and others, respectively. The shopping centers mentioned in the category of others were Laurelwood, Factory Outlet Mall, and Kirby Woods Mall.

Table 4

MALL SHOPPING PATTERNS IN 1981 AND 1982

Mall That Was Most Frequently Shopped By the Panel Members in 1981	
Raleigh Springs Mall	62.5%
Southland Mall	30.8
Other	6.7
Mall That Was Most Frequently Shopped By the Panel Members in 1982	
Mall of Memphis	27.6
Southland Mall	14.3
Raleigh Springs Mall	35.7
Hickory Ridge Mall	18.8
Other	3.6

Demographic data were used to cross-tabulate with the shopping pattern data to determine whether a relationship existed between these two sets of variables. Of the eight demographic variables, only two, age and race, produced statistically significant differences (see Table 5). For respondents who indicated that they shopped most frequently at Hickory Ridge Mall in 1982, less than 6.0 percent were over 60 years old. This compared with 21.3 percent, 17.9 percent, and 13.7 percent of the frequent shoppers at the Mall of Memphis, Southland Mall, and Raleigh Springs Mall, respectively, that were from the same age group. Southland Mall seemed to be the favorite mall for black shoppers, as more than 23.0 percent of the respondents who indicated they shopped most frequently at Southland Mall were black. This perhaps was due to the fact that a large number of black shoppers live in Whitehaven and South Memphis.

Table 5

DEMOGRAPHIC CHARACTERISTICS AND SHOPPING PATTERNS

	Mall of Memphis	Southland Mall	Raleigh Springs Mall	Hickory Ridge Mall	Other
Marital Status					
Single	12.0%	20.5%	15.1%	13.7%	20.0%
Married	69.3	59.0	66.7	64.7	80.0
Divorced	17.3	15.4	11.8	17.6	0.0
Widowed	1.3	5.1	6.5	3.9	0.0
Family Size					
One	16.0	23.1	22.1	25.5	20.0
Two	26.7	30.8	29.5	17.6	40.0
Three	22.7	20.5	17.9	19.6	20.0
Four	24.0	10.3	22.1	25.5	20.0
Five	8.0	7.7	5.3	9.8	0.0
More than Five	2.7	7.7	3.2	2.0	0.0
Age of Head of Family					
30 or Less	18.7	20.5	13.7	15.7	50.0
31 to 40	24.0	33.3	31.6	33.3	10.0
41 to 50	20.0	12.8	21.1	21.6	0.0
51 to 60	16.0	15.4	20.0	23.5	20.0
Over 60	21.3	17.9	13.7	5.9	20.0
Race					
Black	9.3	23.7	6.3	3.9	0.0
White	90.7	76.3	93.7	96.1	100.0
Education					
Some High School or Less	6.7	5.1	5.3	2.0	0.0
High School Graduate	13.3	23.1	25.3	17.6	10.0
Some College	37.3	35.9	28.4	27.5	30.0
College Graduate	21.3	20.5	23.2	27.5	20.0
Post Graduate	21.3	15.4	17.9	25.5	40.0
Occupation					
Professional or Managerial	46.7	46.2	39.8	60.0	50.0
Sales or Clerical	14.7	12.8	18.3	22.0	10.0
Craftsmen/Factory	14.7	10.3	9.7	6.0	10.0
Service Worker	2.7	5.1	4.3	4.0	0.0
Retired	13.3	17.9	20.4	4.0	10.0
Self-Employed	8.0	5.1	4.3	2.0	10.0
Other	0.0	2.6	3.2	2.0	10.0
Income					
Under $10,000	6.8	12.8	7.4	3.9	0.0
$10,000 to $14,999	10.8	12.8	11.7	7.8	0.0
$15,000 to $19,999	9.5	15.4	17.0	11.8	30.0
$20,000 to $24,999	17.6	7.7	11.7	17.6	20.0
$25,000 to $29,999	17.6	10.3	9.6	9.8	10.0
$30,000 to $34,999	12.2	7.7	16.0	11.8	10.0
$35,000 to $39,999	6.8	7.7	10.0	9.8	0.0
Over $40,000	18.9	25.6	10.0	27.5	20.0
Employment of Spouse					
Yes	53.4	34.4	40.8	51.4	40.0
No	46.6	65.6	59.2	48.6	60.0

The area of residence of the respondents was also cross-tabulated with shopping patterns to detect whether the former variable has any effects on the latter variables. As can be seen from Table 6, the respondents seemed to shop at the mall which was nearest their home. Residents of North and Northeast Memphis shopped at Raleigh

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Springs Mall, while residents of South Memphis and Whitehaven shopped at Southland Mall. The opening of the new malls has affected to a greater extent the shopping patterns of those shoppers residing in East Memphis and Germantown than the shoppers living near the old malls. Respondents living in these two areas have changed their shopping patterns by shopping more frequently at the new malls. This was especially true for shoppers who live in Germantown.

Table 6

PLACE OF RESIDENCE AND SHOPPING PATTERNS

Before the Opening of the New Malls:

	Southland Mall	Raleigh Springs Mall	Other
Midtown	37.8 %	59.5 %	3.7%
North Memphis	8.3	91.7	0.0
South Memphis	90.9	0.0	9.1
East Memphis	19.6	67.6	12.8
Germantown	25.0	50.0	25.0
Frayser	0.0	100.0	0.0
Millington	0.0	100.0	0.0
Bartlett	0.0	100.0	0.0
Whitehaven	96.9	0.0	3.1
Raleigh	0.0	100.0	0.0
TOTAL	30.6%	62.7%	6.7%

After the Opening of the New Malls:

	Mall of Memphis	Southland Mall	Raleigh Springs Mall	Hickory Ridge Mall	Other
Midtown	33.3%	15.4%	20.5%	25.6%	5.2%
North Memphis	0.0	0.0	100.0	0.0	0.0
South Memphis	36.4	45.5	0.0	18.2	0.0
East Memphis	43.1	2.6	23.3	25.9	5.1
Germantown	28.6	0.0	0.0	71.4	0.0
Frayser	4.5	0.0	95.5	0.0	0.0
Millington	0.0	0.0	100.0	0.0	0.0
Bartlett	0.0	0.0	95.2	0.0	4.8
Whitehaven	15.6	78.1	0.0	6.3	0.0
Raleigh	0.0	0.0	85.7	0.0	14.3
Total	27.6%	14.3%	35.7%	18.8%	2.6%

Conclusions

With the addition of two major planned shopping centers, the structure of retailing in Memphis changed significantly and permanently. However, changes in shopping habits were much less permanent. Shopping patterns changed, but the changes were not lasting. People investigated the new centers but returned to prior patterns. The greatest effect in shopping patterns has been on those residents of East Memphis and Germantown. Panel members who reside in those areas find it more convenient and easier to reach the two new shopping centers. Raleigh Springs Mall is the most popular shopping center of the panelists in this study.

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EFFECTIVE CONFLICT MANAGEMENT

*Kathy Fitzpatrick and Thomas W. Zimmerer**

"Conflict between employees or groups is not tolerated here—we want a smooth running organization." This statement reflects a theme which is dominant among many managers. Statements such as the following have a number of significant implications for managers:

1. I don't want to hear about conflict; insure that all conflicts are dealt with at your level and never bring them to my level.
2. "Good managers" do not allow conflicts among their employees or with other groups; therefore, if you want to be considered for promotion, don't have conflict problems.
3. You are not going to receive much support from upper management when, and if, conflict does arise.
4. Conflict has most likely been ignored or smoothed over in the past.

In short, conflict within a manager's group has been perceived as a sign that the manager is not effective at those mystical interpersonal skills associated with keeping the troops in line. As we investigate the sources of conflict, it becomes obvious that it is unwise both to ignore the causes of conflict and not to take a positive approach to managing conflict.

What is Conflict and What is Its Origin?

Conflict may be described as stemming from a variety of sources:

1. "An opposition or tension between two or more parties due to actual or perceived incompatibility of goals or means of achieving them" (Bacon, p. 32);
2. "Behavior by organization members which is expended in opposition to other members" (Harrison, p. 18);
3. "Deliberate interference with another person's goal achievement" (Kilmann and Thomas, pp. 59-60); and
4. Interpersonal hostility (Kilmann and Thomas, pp. 59-60).

In recent years a number of distinguished researchers have concentrated on the identification of the causes of conflict within organizations. At least one author has suggested that conflict originates externally, given that business operates in an environment in which organizations must respond to conflict rather than insulate themselves from it (Lebell, p. 566). The majority of writers, while recognizing the conflict-producing nature of the external environment, have focused on internal sources of conflict. Several have suggested that organizational conflict is inevitable (Phillips and Cheston, p. 83; Rahim, p. 99). This inevitability would seem to be due to the significant interdependencies among departments, groups, etc.; the mismanagement of those interdependencies "fuels the fires" of conflict.

Walton and his associates conducted a study in which it was hypothesized that the amount of conflict in an organization was determined by the organizational context in which interdepartmental transactions occurred (Walton et al., p. 527). Several contextual factors were shown in this study to be determinants of conflict. These included:

1. Ambiguity in jurisdictional boundaries;
2. Barriers or obstacles to communication among departments;
3. Social friction among departments;
4. Frustration of task conditions in departments[illegible]
5. Incentives for one or both of the departm[illegible] suboptimize (Walton et al., p. 527).

The desire of one group to dominate another group was seen by one author as a common source of conflict within the organization (Harrison, p. 18); another listed the following three factors as conditions which are conducive to conflict:

1. Dependence of one group on the other;
2. Situations in which considerable association between the parties is required;
3. The need for consensus (Filley, pp. 9-12).

Wolff noted that within the area of research and development, conflict often erupts as a result of unclear career paths (Wolff, p. 10). This idea was echoed by Lebell, whose work concentrated on conflict between management and professional/technical staff (Lebell, pp. 566-72).

Three major sources of conflict were discussed by Phillips and Cheston. These were:

1. Communication—differences in semantics, unfamiliar language, ambiguous or incomplete information;
2. Structures—power struggles between departments with conflicting objectives or reward systems, competition for scarce resources, interdependence;
3. Personal—incompatible personal goals or social values of employees with the role behaviors required by their jobs, authoritarian or dogmatic personalities, etc. (Phillips and Cheston, p. 77).

**The authors are, respectively, Assistant Professor of Management, Appalachia State University, Boone, North Carolina; and Professor of Management, Clemson University, Clemson, South Carolina.*

Noteworthy in this study was the discussion of the structure of the organization as a source of conflict, in which it was stated that power struggles between departments with conflicting needs and objectives or reward systems result in competition and conflict. Here, the competition for scarce resources and the interdependence of departments or subunits were considered to be the major sources of organizational conflict (Phillips and Cheston, pp. 77-80).

Bacon contended that the major reason for conflict between subunits of the organization was the result of differences in perceptions, values, interests, and objectives of the participants (Bacon, p. 33). Harrison also noted that the principal sources of conflict in formal organizations were the divergence of goals an objectives and competition for scarce resources (Harrison, p. 18).

An extensive study of conflict within the organization was conducted by Labovitz. In answer to the question of why conflict exists, he wrote that "... whenever human beings compete for scarce resources or share different organizational goals and time perspectives, conflict is likely to exist" (Labovitz, p. 31). He went on to note that a complex organization is characterized by a high degree of differentiation, and that diverse groups necessarily differ as to goals and objectives. Because differentiation exists, there is a need for some mechanism to integrate the departments or subunits. Labovitz contends that the source of conflict is not the differentiation (Corwin, p. 507).

Filley summarized the sources of organizational conflict as follows:

1. Conflict of interest among "competing departments";
2. Barriers to communication;
3. Dependency among departments;
4. Degree of association between departments, where conflict increases as participation increases;
5. Need for consensus, where conflict increases as need for consensus increases (Filley, pp. 9-11).

The principal causes of organizational conflict can be seen as by-products of the structure of the organization. As the organization's complexity increases, the number and types of situations which produce conflict also increase. As society moves toward more sophisticated, highly differentiated organizations, the need for a viable means of dealing with conflict becomes ever more crucial.

Is All Conflict Negative?

Organizational conflict has evolved from a "negative" detrimental factor in the achievement of organizational goals and objectives to a necessary, if not positive, element in achieving those ends (Kleiner, p. 3). In fact, it has been stated that conlict is essential in that it forces the organization to focus on its problems and to adapt and change within its environment (Labovitz, p. 30). The implication here is that an organization which has the ability to adapt and has experienced change as a result of conflict will be better able to survive; conflict has, therefore, been viewed as an aid in helping the organization to become more productive. It is not the conflict itself which is helpful, but the successful resolution of conflict and the experience which managers obtain as a result of it which is beneficial (Bacon, p. 32). While this point may, at first glance, seem somewhat arbitrary, it is essential to the understanding of the role of conflict in organizational growth. Furthermore, if it is recognized that it is not the conflict itself, but the manner in which it is resolved or controlled which is important, then an important step can be taken toward teaching managers how to cope with and use conflict (Labovitz, p. 32).

Is it always true that conflict is productive? Certainly, in moderate amounts conflict may be helpful, but conflict which is not in control can produce negative results. When conflict within an organization causes the goals of the organization to be compromised, then the conflict is no longer beneficial. An equilibrium must be achieved between conflict and resolution such that the objectives of the organization can be pursued while maintaining an ability to adapt to changes within the environment (Wolff, p. 10). Robbins has pointed out that since conflict has traditionally been considered destructive, managers have been prone to avoid it. The reasons for this behavior are summarized as follows:

1. Conflict is a source of anxiety and stress for individuals who experience it;
2. Unity and harmony among special groups may be threatened;
3. Many organizations evaluate and reward managers on the basis of their ability to maintain an harmonious and peaceful working environment; the absence of conflict is, therefore, taken as a sign of managerial effectiveness (Robbins, pp. 67-72).

Managing and Controlling Conflict

Recognition of the sources or causes of conflict represents the first step in its management. Several studies have dealt with what might be termed a second phase in the management of conflict—that is, controlling conflict in organizations.

Bacon outlined an Interactive Decision Method (IDM) for conflict control (Bacon, p. 36). This problem-solving approach offers a "win-win" solution to conflict, when the objective is resolution of underlying conflict. Bacon noted that the IDM solution is not, however, always possible. Successful resolution, he stated, requires that all involved parties believe that a solution is possible, and that they recognize that all views are legitimate. Additionally, to be successful, IDM requires open communication and information exchange between parties involved in the conflict (Bacon, pp. 36-38).

Kleiner noted that three major methods existed for managing conflict: competing, bargaining, and collaborating (Kleiner, p. 3). Competing, or "fighting-to-win," successfully employed several somewhat negative tactics, including:

1. Using threats and bluffs;
2. Using unpredictable strategies;
3. Using non-rational arguments to defend one's position (Kleiner, p. 3).

The collaboration technique cited by Kleiner uses differing tactics in implementing a problem-solving approach. These include:

1. Willingness to disclose data and open communication;
2. Understanding of needs—both personal and organizational;
3. Use of predictable strategies;
4. Failure to use threats or bluffs (Kleiner, p. 4).

The collaboration-competition approaches to managing conflict are extremes of a continuum; most conflict management techniques appear to fall between the two. In determining the best approach to conflict management, the individual, the other party, and the situation must be evaluated on an individual basis (Kleiner, p. 5). Thomas' study of 28 CEOs noted that the competition approach was appropriate when a quick decision was necessary, or when the system's functioning was in danger of being compromised (Thomas, cited in Kleiner, p. 5). The "whole" is seen as being more important than the sum of its individual parts. Success in conflict management is contingent upon understanding the interdependencies of the system and developing a flexible position with respect to the system (Kleiner, p. 6).

Phillips and Cheston noted that the "tough-guy" and "problem-solver" were the most frequently used approaches to conflict management, but that compromise and avoidance were also frequently used (Phillips and Cheston, p. 76). The tough-guy approach was seen to be advantageous in that one party was able to use superior powers to impose a decision and therefore remove the conflict; however, the researchers did not consider the effect of a forced resolution on informal structures, where it is likely that the conflict would re-emerge. The problem-solving, or joint resolution approach, was said to have as a benefit a shared commitment to the solution, and it was thought to serve as a basis for resolving future conflicts (Phillips and Cheston, pp. 76-77).

Filley identified three basic ways in which conflicts can be resolved: win-win, win-lose, and lose-lose. In the win-win resolution approach, rival groups successfully identify solutions which allow both to achieve their desired goals and objectives—that is, both sides are winners. Lose-lose conflict resolution, which is at the opposite end of the spectrum, requires that each rival group give up some of its desired goals through some form of compromise. Neither group gets all of what it wants, so, in effect, both sides are losers. With win-lose resolution, one party, using various methods, manages to win the conflict by obtaining its goals while frustrating the other party's attempt to meet its goals (Filley, pp. 25-30). It has been noted that in the win-win situation, conflict management must be designed to stimulate as well as resolve conflict—the major focus is on the attainment of a solution (Robbins, p. 13). The heart of the win-win approach is using participative management to gain consensus and commitment to objectives (Labovitz, p. 33).

Confrontation is the hallmark of both effective organizations and effective managers. Confronting conflict situations and using strategies that produce win-win results are the keys to the successful management of conflict.

Guidelines for Managing Conflict

It has been said that "the first step in managing conflict is to select managers with potential or aptitude for conflict management" (Rosenbaum, quoted in Wolff, pp. 10-11). The next step is to train these managers in those skills important to conflict management. Walton suggested that the successful manager should encourage the emergence of differences, and should then confront them. Furthermore, the manager, instead of being judgmental, should help to clarify the issues, recognize and accept the feelings of others, and suggest procedures for resolving differences (Walton, pp. 117-127).

Kilmann and Thomas developed a "meta" model of conflict management. They suggested the following steps in managing conflict:

1. Perceiving/experiencing unacceptable conflict;
2. Diagnosing sources of conflict;
3. Intervention (Kilmann and Thomas, p. 60).

It has been noted that in order to achieve a mutually acceptable solution to conflict, the participants must separate the process of determining the problem from the search for a solution and the evaluation of alternatives (Filley, pp. 109-112).

Welds suggested several ways to deal with conflict in a work setting. An important step was to estimate the pertinence of the conflict—in other words, how important is the particular difference in the overall achievement of goals? Another important point in conflict resolution was to monitor and evaluate progress by means of feedback and consultation (Welds, p. 383).

An experimental study by Phillips and Cheston suggested that the four stages of conflict resolution could lead to the development of guidelines for management of conflict. The four stages are:

1. Facing up to the conflict;
2. Planning the resolution;
3. Implementing the plan;
4. Following up the procedure (pp. 82-83).

Formal procedures for conflict management require that the participants be willing to participate in the resolution process and that they recognize the nature of the conflict. The ability to plan, implement, and evaluate is also crucial in the effective management of conflict.

Summary

The ability of management to deal effectively with organizational conflict depends on its ability to diagnose and understand the differences between the groups within the organization and to select appropriately from the variety of conflict reduction techniques (Harrison, p. 18). This statement, made two years ago, has as much validity today—a fact which is supported by the literature reviewed. Wolff noted that the failure to resolve conflict was "contagious," and that over time it tended to produce polarization within organizational subunits (Wolff, p. 10). When a "win-lose" mentality develops as a result of conflict, the organizational objectives take second place to the defense of departmental or personal egos. The result is that the ability of the organization to function is compromised because it must focus its energies inward rather than outward. When the parts fail to function properly, the "whole" has to suffer. As was pointed out by Labovitz, conflict can have either a positive or a negative effect on the organization. Effective management requires that an optimal level of conflict be maintained so as to allow benefits to the organization from its presence while minimizing its consequences (Labovitz, p. 37).

In order for conflict to be resolved, a plan must be available which allows for successful intervention. Sheane proposed eight areas for intervention in conflict:

1. Assess the situation;
2. Fragment the problem;
3. Restructure the "power-dynamics";
4. Understand the dynamics of "threat-counterthreat";
5. Improve the credibility of the offer(s);
6. Break deadlocks;
7. Make agreements;
8. Influence the process (Sheane, p. 515).

Although not complete, this list provides the manager with some clues as to "where to start" in conflict resolution and management.

In summary, the literature shows that the extent to which management has an understanding of conflict and its treatment has a dramatic effect on the successful resolution of differences within the organization. The research shows the importance of adaptability in the area of conflict management. In light of current research, it is clear that organizations which use a single method of conflict resolution or a unilateral approach to conflict management should reassess their practices. The alternative is the focusing of precious effort on making the organization run rather than making the organization run in a more productive manner.

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SMALL MANUFACTURERS AND THEIR UTILIZATION OF SOURCES OF ASSISTANCE

*Satish Mehra**

Introduction

Any business organization, large or small, faces a variety of problems in today's competitive and dynamic business environment. Large businesses have the resources to study their new concepts and ideas, and then, if they prove feasible, to forcibly push for their success. A few failures of new ideas for large manufacturing businesses generally do not make much impact on their smooth functioning. Unfortunately for small businesses, given the cost of money, even a minor failure can cause a total failure of the company.

Among other problems, lack of operating knowledge appears to be a significant problem in small manufacturing operations (Vozikis, 1980; Mehra, 1982). Throughout the life cycle—from the very beginning of an idea through the transformation of the idea into a viable product—of a manufacturing process, much information is needed to overcome the various problems that one encounters. Therefore, it becomes necessary for owners/operators of small manufacturing businesses to seek timely assistance from various sources.

Objectives Of the Study

The research for this study was conducted during the summer of 1982 to explore, on a pilot basis, the operational problems of small manufacturing businesses in the Memphis and Mid-South area and to ascertain the extent to which these businesses have sought assistance, if any, from various sources. Specifically, this study was conducted to develop a data base consisting of operational problem areas, the timing at which these problems occur (as shown in Figure 1), and opportunities for providing training programs to assist small manufacturing businesses. An additional objective of the study was to forecast areas in which assistance will be sought in coming years. However, given the limitations of space, this article will address only two aspects: first, the problems encountered; and second, utilization of sources of assistance by small manufacturers to solve these problems.

Methodology and the Sample

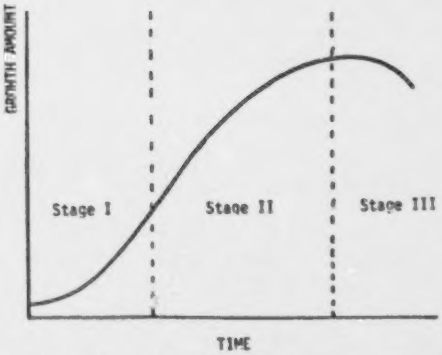
The research methodology involved the use of a questionnaire to collect data on various factors concerning the day-to-day operation of a small manufacturing business. A tested and validated questionnaire was administered by mail to 150 randomly selected small manufacturing businesses. The response rate of usable questionnaires was approximately 34 percent. As indicated below, a variety of manufacturing businesses were represented in the study:

1. General manufacturing shops including retail trade
2. Construction equipment
3. Automotive equipment/electronics/electrical goods
4. Transportation and transportation equipment
5. Food and kindred products
6. Lumber and wood products
7. Paper, printing, and allied businesses
8. Chemical, paint, and allied industries
9. Rubber and plastics
10. Musical and publishing

The majority (66 percent) of the respondents were either the president or owner of the business and had a college degree. The typical business had existed for at least ten years and employed a minimum of 50 people. A large majority of the respondents indicated that major decisions are made by one individual, the president or owner of the organization.

Figure 1

LIFE CYCLE ANALYSIS



The Study

The study was divided into various topical areas based upon the operational aspects of a small manufacturing enterprise. These areas are as follows:

1. Major problems encountered by small manufacturers
2. Various sources of assistance available to small manufacturers including:
   a. Awareness of these sources

Associate Professor, Department of Management, Memphis State University, Memphis, Tennessee.

    b. Utilization of these sources
    c. Evaluation of these sources

3. Interaction with governmental agencies (including local, state, and federal)
4. Current state of affairs in operating small businesses, i.e.:
    a. Latest developments in small business management
    b. Use of computers
    c. Export opportunities
5. Need for training programs to assist small manufacturing operations

Data were gathered on these topical areas through the use of a questionnaire mailed to small manufacturers, and the results were tabulated according to simple frequency procedure. The next section briefly discusses the problems encountered by small manufacturers, with the following section analyzing the usage of the sources of assistance.

Discussion

Problems of Small Manufacturers

To determine the nature of problems encountered by small manufacturers, a variety of problem areas were listed in the questionnaire used in this study. Respondents were asked to check all the problem areas that they considered pertinent to their respective businesses. From the responses, a list of the 12 most frequently cited problems that needed outside help was prepared. Table 1 presents these problem areas in order of their seriousness to small manufacturing businesses.

Accounting/bookkeeping and other record-keeping matters seem to be of major concern to small manufacturers. Taxes, government regulations, and legal matters were the next major problematic areas mentioned by respondents. It is no surprise that interfacing with government agencies is harder for small manufacturers, given the fact that even the large manufacturers cannot cope with the various regulations these days.

Another commonly cited problem area is the availability of skilled workers to provide needed support in technical environments. This same problem may be the reason for two additional problems, i.e., forecasting demand for finished products, and the problem of quality control. However, since advertising products are also mentioned as a problem, inability to forecast accurately could be tied to the problem of advertising. Money-related problems seem to stifle manufacturers to a greater extent as indicated by respondents' mentioning three other problem areas: inflation, recession, and credit collections. These problems altogether can easily cause a severe cash flow strain on small businesses.

Sources of Assistance

Given that a number of problems can be encountered by small manufacturers, this study further documented the sources of assistance sought by these businesses. This section was divided into three parts. First, the respondents were asked to indicate their awareness of the various possible sources of assistance. To help our respondents in this and the other two parts, a list of potential sources was prepared after consultation with various small manufacturers. It is this list that was referred to again and again to solicit responses. Space was also provided for participants to write in their preferences, if any. The second part of this section dealt with the utilization of the services of these various assisting agencies. The third part dealt with the satisfaction-dissatisfaction aspect of the sources of assistance that are available to small manufacturers. Findings from the study about these three points are presented in Tables 2, 3, and 4, respectively.

Table 1

MAJOR PROBLEMS ENCOUNTERED
BY SMALL MANUFACTURERS

Accounting/bookkeeping-records	37%
Taxes	34%
Government regulations	32%
Legal problems/information	29%
Insurance costs	29%
Lack of skilled workers	29%
Inflation	22%
Credit and collections	20%
Advertising of your products	17%
Forecasting demand for your product	17%
Recession	17%
Quality control	17%

Table 2

SOURCES OF ADVICE AND/OR HELP

Do you recognize the following as a potential source of advice and/or help with business?

Source	Yes	No
Consultants	87%	13%
Trade associations	90%	10%
Banks	90%	10%
Other manufacturers	93%	7%
Friends	88%	12%
Universities	83%	17%
Magazines, journals, etc.	93%	7%
Federal government (including SBA)	81%	19%
State government	81%	19%
Local government	71%	29%
SCORE	55%	45%

Table 3

UTILIZATION OF SOURCES OF ADVICE AND/OR HELP

Have you utilized advice and/or help from the following?

Source	Yes	No
Consultants	69%	31%
Trade associations	69%	31%
Banks	86%	14%
Other manufacturers	74%	26%
Friends	71%	29%
Universities	35%	65%
Magazines, journals, etc.	92%	8%
Federal government (includes SBA)	40%	60%
State government	10%	90%
Local government	14%	86%
SCORE	38%	72%

Table 4

SATISFACTION WITH ADVICE AND/OR HELP

Were you satisfied with the advice and/or help received?

Source	Yes	No
Consultants	78%	22%
Trade associations	82%	18%
Banks	83%	17%
Other manufacturers	88%	12%
Friends	91%	9%
Universities	75%	25%
Magazines, journals, etc.	75%	25%
Federal government (includes SBA)	56%	44%
State government	50%	50%
Local government	100%	0%
SCORE	100%	0%

From a list of 11 agencies mentioned in the questionnaire (Table 2), the two sources mentioned as the most recognizable potential sources of assistance were magazines/journals and other manufacturers. Trade associations and banks shared the *second* spot, and friends were mentioned as the *third* best source of advice or help. Management consultants were mentioned as the *fourth* source of guidance, followed by universities as the *fifth* source. The remaining sources mentioned were federal, state, and local agencies. Based upon these findings, one is led to believe that the sources (such as federal, state, and local agencies; SBA; Chamber of Commerce; SCORE; etc.) that should be providing inexpensive and reliable information and assistance are not being considered as the first sources of help. However, they are still being recognized as potential sources. Nonetheless, it does create a stigma where a small manufacturer seeks and relies on the advice/help of other manufacturers, friends, and magazines for solving his problems. This may result in good as well as not-so-good advice being passed on from one source to another. In either case, it may result in expensive actions and reactions.

When looking into the utilization of these assistance sources (Table 3), once again the four heavily utilized sources of assistance are (in order): magazines/journals, banks, other manufacturers, and friends. The least used sources are universities and governmental agencies; sources that can be regarded as less expensive and more reliable. However, when asked about the degree of satisfaction received while utilizing the same sources of assistance (Table 4), a slightly different picture emerges. The heavily utilized sources of assistance are not the ones found to be very satisfactory sources. Friends and other manufacturers are found to be more reliable sources than others. Table 4 presents a more detailed ranking of satisfactory sources.

Summary and Conclusions

This study was an attempt to analyze the problems of Mid-South area small manufacturing businesses and their utilization of sources of assistance. To achieve its objectives, the study surveyed a total of 150 randomly selected small manufacturing businesses and documented the findings from a response rate of 34 percent. Data were collected on a variety of operational problems related to small manufacturing operations.

The first segment of the questionnaire solicited information on major problem areas. From a list of 30 possible problem areas, accounting and other money-related issues seem to be of major concern, followed by government regulations (Table 1). Skilled workers, a necessary ingredient for any successful manufacturing process, seem to be in short supply for Mid-South area manufacturers, and this problem may also be causing quality control problems.

The second segment in this study examined the sources of assistance available to small manufacturers including the use and evaluation of these sources. It appears that small manufacturers are aware of a variety of sources that can assist them in their operational problems (Tables 2, 3, and 4). Dominant sources of assistance known to small businesses are magazines/journals, fellow manufacturers, banks, and trade associations. However, government sources of help are not the dominant ones mentioned by the respondents. It is not surprising that, as shown in Tables 3 and 4, these same well-known sources rank quite high in terms of their usage and evaluation by small manufacturers. Nonetheless, it needs to be noted that the sources of assistance mentioned by the respondents may or may not be reliable. Moreover, from the list of available/known sources, one can conclude that there is a need to provide a unified agency to furnish reliable information/assistance to help small manufacturing businesses. It can take the form of advisory groups, referral services, and/or volunteer audit groups. Irrespective of their name, the objective of these groups should be to provide timely, accurate, and reliable assistance (or information on sources of assistance) to small manufacturers.

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